

CONMED CORP  
Form 10-Q  
July 25, 2014

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 quarter ended  
June 30, 2014

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

16-0977505  
(I.R.S. Employer  
Identification No.)  
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 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

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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  Accelerated filer  Non-accelerated filer  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

The number of shares outstanding of registrant's common stock, as of July 22, 2014 is 27,344,609 shares.

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CONMED CORPORATION  
QUARTERLY REPORT ON FORM 10-Q  
FOR THE QUARTER ENDED JUNE 30, 2014

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## PART I FINANCIAL INFORMATION

## Item 1.

## CONMED CORPORATION

## CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited, in thousands except per share amounts)

	Three Months Ended		Six Months Ended	
	June 30, 2013	2014	June 30, 2013	2014
Net sales	\$ 192,993	\$ 188,150	\$ 380,007	\$ 370,091
Cost of sales	90,077	87,122	174,409	166,481
Gross profit	102,916	101,028	205,598	203,610
Selling and administrative expense	77,174	74,026	154,899	147,844
Research and development expense	6,591	6,854	12,285	13,764
Medical device excise tax	1,406	1,369	2,986	2,718
Other expense	2,093	2,839	3,906	6,036
	87,264	85,088	174,076	170,362
Income from operations	15,652	15,940	31,522	33,248
Loss on early extinguishment of debt	—	—	263	—
Interest expense	1,383	1,571	2,749	3,032
Income before income taxes	14,269	14,369	28,510	30,216
Provision for income taxes	4,736	4,114	8,485	11,335
Net income	\$ 9,533	\$ 10,255	\$ 20,025	\$ 18,881
Comprehensive income	\$ 7,380	\$ 11,597	\$ 18,754	\$ 21,174
Per share data:				
Net income				
Basic	\$ 0.35	\$ 0.38	\$ 0.72	\$ 0.69
Diluted	0.34	0.37	0.71	0.68
Dividends per share of common stock	\$ 0.15	\$ 0.20	\$ 0.30	\$ 0.40
Weighted average common shares				

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Basic	27,591	27,257	27,860	27,303
Diluted	27,983	27,753	28,258	27,803

See notes to consolidated condensed financial statements.

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

	December 31, 2013	June 30, 2014
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$54,443	\$60,414
Accounts receivable, net	140,426	135,081
Inventories	143,211	157,006
Income taxes receivable	3,805	4,917
Deferred income taxes	13,202	13,101
Prepaid expenses and other current assets	17,045	14,807
Total current assets	372,132	385,326
Property, plant and equipment, net	138,985	137,758
Deferred income taxes	1,183	1,147
Goodwill	248,428	248,427
Other intangible assets, net	319,440	312,894
Other assets	10,340	11,772
Total assets	\$1,090,508	\$1,097,324
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Current portion of long-term debt	\$1,140	\$1,187
Accounts payable	27,448	26,760
Accrued compensation and benefits	33,426	28,199
Income taxes payable	2,116	2,362
Other current liabilities	47,135	46,116
Total current liabilities	111,265	104,624
Long-term debt	214,435	244,830
Deferred income taxes	113,199	117,331
Other long-term liabilities	45,290	28,385
Total liabilities	484,189	495,170
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; 31,299,194 shares issued in 2013 and 2014, respectively	313	313
Paid-in capital	326,436	324,366
Retained earnings	395,889	403,848

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Accumulated other comprehensive loss	(17,572	) (15,279	)
Less: 3,718,332 and 3,958,389 shares of common stock in treasury, at cost in 2013 and 2014, respectively	(98,747	) (111,094	)
Total shareholders' equity	606,319	602,154	
Total liabilities and shareholders' equity	\$1,090,508	\$1,097,324	

See notes to consolidated condensed financial statements.

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

	Six Months Ended	
	June 30,	
	2013	2014
Cash flows from operating activities:		
Net income	\$20,025	\$18,881
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	9,168	9,473
Amortization	14,648	12,831
Stock-based compensation	2,496	2,518
Deferred income taxes	5,038	3,837
Loss on early extinguishment of debt	263	—
Increase (decrease) in cash flows from changes in assets and liabilities:		
Accounts receivable	(2,689	) 5,584
Inventories	(1,581	) (19,163
Accounts payable	(2,207	) (1,353
Income taxes receivable (payable)	(1,171	) (1,013
Accrued compensation and benefits	(7,393	) (5,260
Other assets	(3,714	) 834
Other liabilities	(9,729	) (2,256
	3,129	6,032
Net cash provided by operating activities	23,154	24,913
Cash flows from investing activities:		
Purchases of property, plant and equipment	(8,201	) (8,641
Net cash used in investing activities	(8,201	) (8,641
Cash flows from financing activities:		
Net proceeds from common stock issued under employee plans	10,366	953
Repurchase of common stock	(44,729	) (16,862
Proceeds from senior credit agreement	73,000	31,000
Payment related to distribution agreement	(34,000	) (16,667
Payments on mortgage notes	(515	) (558
Payments on senior subordinated notes	(227	) —
Payments related to issuance of debt	(1,725	) —
Dividends paid on common stock	(8,445	) (10,987
Other, net	7,090	1,857
Net cash provided by (used in) financing activities	815	(11,264
Effect of exchange rate changes on cash and cash equivalents	(1,365	) 963
Net increase in cash and cash equivalents	14,403	5,971
Cash and cash equivalents at beginning of period	23,720	54,443



Cash and cash equivalents at end of period	\$38,123	\$60,414
Non-cash financing activities:		
Dividends payable	\$4,123	\$5,468

See notes to consolidated condensed financial statements.

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

## Note 1 – Operations

CONMED Corporation (“CONMED”, the “Company”, “we” or “us”) is a medical technology company with an emphasis on surgical devices and equipment for minimally invasive procedures and monitoring. The Company’s products are used by surgeons and physicians in a variety of specialties including orthopedics, general surgery, gynecology and gastroenterology.

## 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. Results for the period ended June 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014.

The consolidated condensed financial statements and notes thereto should be read in conjunction with the consolidated financial statements and notes for the year ended December 31, 2013 included in our Annual Report on Form 10-K.

## Note 3 – Comprehensive Income

Comprehensive income consists of the following:

	Three Months Ended		Six Months Ended June	
	June 30,	2014	30,	2014
	2013		2013	
Net income	\$9,533	\$10,255	\$20,025	\$18,881
Other comprehensive income:				
Pension liability, net of income tax	461	269	922	539
Cash flow hedging gain (loss), net of income tax	379	(528)	) 2,506	197
Foreign currency translation adjustment	(2,993)	) 1,601	(4,699)	) 1,557
Comprehensive income	\$7,380	\$11,597	\$18,754	\$21,174

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Accumulated other comprehensive income (loss) consists of the following:

	Cash Flow Hedging Gain (Loss)	Pension Liability <sup>a</sup>	Cumulative Translation Adjustments	Accumulated Other Comprehensive Income (Loss)
Balance, December 31, 2012	\$(1,130	) \$(30,375	) \$3,924	\$(27,581
Other comprehensive income before reclassifications	2,800	—	(4,699	) (1,899
Amounts reclassified from other accumulated comprehensive income before tax <sup>b</sup>	(467	) 922	—	455
Tax expense (benefit)	173	—	—	173
Net current-period other comprehensive income	2,506	922	(4,699	) (1,271
Balance, June 30, 2013	\$1,376	\$(29,453	) \$(775	) \$(28,852
	Cash Flow Hedging Gain (Loss)	Pension Liability <sup>a</sup>	Cumulative Translation Adjustments	Accumulated Other Comprehensive Income (Loss)
Balance, December 31, 2013	\$(1,385	) \$(18,918	) \$2,731	\$(17,572
Other comprehensive income before reclassifications	(150	) —	1,557	1,407
Amounts reclassified from other accumulated comprehensive income before tax <sup>b</sup>	551	539	—	1,090
Tax expense (benefit)	(204	) —	—	(204
Net current-period other comprehensive income	197	539	1,557	2,293
Balance, June 30, 2014	\$(1,188	) \$(18,379	) \$4,288	\$(15,279

(a) All amounts are net of tax.

(b) The cash flow hedging gain (loss) and pension liability accumulated other comprehensive income components are included in sales or cost of sales and as a component of net periodic pension expense (income), respectively. The amounts recorded in the charts above are for the six months ended June 30, 2013 and 2014. For the three months ended June 30, 2013, -\$0.4 million of the cash flow hedging gain and \$0.5 million of the pension liability were reclassified from accumulated other comprehensive income to the statement of income. For the three months ended June 30, 2014, \$0.4 million of the cash flow hedging loss and \$0.3 million of the pension liability were reclassified from accumulated other comprehensive income to the statement of income. Refer to Note 4 and Note 9, respectively, for further details.

Note 4 – Fair Value of Financial Instruments

We enter into derivative instruments for risk management purposes only. We operate internationally and, in the normal course of business, are exposed to fluctuations in interest rates, foreign exchange rates and commodity prices. These fluctuations can increase the costs of financing, investing and operating the business. We use forward contracts, a type of derivative instrument, to manage certain foreign currency exposures.

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By nature, all financial instruments involve market and credit risks. We enter into forward contracts with major investment grade financial institutions and have policies to monitor the credit risk of those counterparties. While there can be no assurance, we do not anticipate any material non-performance by any of these counterparties.

**Foreign Currency Forward Contracts.** We hedge forecasted intercompany sales denominated in foreign currencies through the use of forward contracts. We account for these forward contracts as cash flow hedges. To the extent these forward contracts meet hedge accounting criteria, changes in their fair value are not included in current earnings but are included in accumulated other comprehensive loss. These changes in fair value will be recognized into earnings as a component of sales or cost of sales when the forecasted transaction occurs. The notional contract amounts for forward contracts outstanding at June 30, 2014 which have been accounted for as cash flow hedges totaled \$124.9 million. Net realized gains (losses) recognized for forward contracts accounted for as cash flow hedges approximated \$0.4 million and \$(0.4) million for the three months ended June 30, 2013 and 2014, respectively, and \$0.5 million and \$(0.6) million for the six months ended June 30, 2013 and 2014, respectively. Net unrealized losses on forward contracts outstanding, net of tax, which have been accounted for as cash flow hedges and which have been included in other comprehensive income, totaled \$1.2 million at June 30, 2014. It is expected these unrealized losses will be recognized in the consolidated condensed statements of comprehensive income in 2014 and 2015.

We also enter into forward contracts to exchange foreign currencies for United States dollars in order to hedge our currency transaction exposures on intercompany receivables denominated in foreign currencies. These forward contracts settle each month at month-end, at which time we enter into new forward contracts. We have not designated these forward contracts as hedges and have not applied hedge accounting to them. The notional contract amounts for forward contracts outstanding at June 30, 2014 which have not been designated as hedges totaled \$38.0 million. Net realized gains (losses) recognized in connection with those forward contracts not accounted for as hedges approximated \$0.0 million and \$(0.7) million for the three months ended June 30, 2013 and 2014, respectively, offsetting gains (losses) on our intercompany receivables of \$(0.2) million and \$0.5 million for the three months ended June 30, 2013 and 2014, respectively. Net realized gains (losses) recognized in connection with those forward contracts not accounted for as hedges approximated \$0.8 million and \$(0.5) million for the six months ended June 30, 2013 and 2014, respectively, offsetting gains (losses) on our intercompany receivables of \$(1.6) million and \$0.2 million for the six months ended June 30, 2013 and 2014, respectively. These gains and losses have been recorded in selling and administrative expense in the consolidated condensed statements of comprehensive income.

We record these forward foreign exchange contracts at fair value; the following tables summarize the fair value for forward foreign exchange contracts outstanding at December 31, 2013 and June 30, 2014:

December 31, 2013	Asset Balance Sheet Location	Fair Value	Liabilities Balance Sheet Location	Fair Value	Net Fair Value
Derivatives designated as hedged instruments:					
Foreign exchange contracts	Other current liabilities	\$ (975	) Other current liabilities	\$ 3,172	\$ 2,197
Derivatives not designated as hedging instruments:					
Foreign exchange contracts	Other current liabilities	(52	) Other current liabilities	78	26

Total derivatives	\$(1,027 )	\$3,250	\$2,223
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June 30, 2014	Asset Balance Sheet Location	Fair Value	Liabilities Balance Sheet Location	Fair Value	Net Fair Value
Derivatives designated as hedged instruments:					
Foreign exchange contracts	Other current liabilities	\$(1,222 )	Other current liabilities	\$3,107	\$1,885
Derivatives not designated as hedging instruments:					
Foreign exchange contracts	Other current liabilities	—	Other current liabilities	51	51
Total derivatives		\$(1,222 )		\$3,158	\$1,936

Our forward foreign exchange contracts are subject to a master netting agreement and qualify for netting in the consolidated balance sheets. Accordingly, at December 31, 2013 and June 30, 2014 we have recorded the net fair value of \$2.2 million and \$1.9 million, respectively, in other current liabilities.

**Fair Value Disclosure.** FASB guidance defines fair value, establishes a framework for measuring fair value and related disclosure requirements. This guidance applies when fair value measurements are required or permitted. The guidance indicates, among other things, that a fair value measurement assumes that the transaction to sell an asset or transfer a liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. Fair value is defined based upon an exit price model.

**Valuation Hierarchy.** A valuation hierarchy was established for disclosure of the inputs to the valuations used to measure fair value. This hierarchy prioritizes the inputs into three broad levels as follows. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities. Level 2 inputs are quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets in markets that are not active, inputs other than quoted prices that are observable for the asset or liability, including interest rates, yield curves and credit risks, or inputs that are derived principally from or corroborated by observable market data through correlation. Level 3 inputs are unobservable inputs based on our own assumptions used to measure assets and liabilities at fair value. A financial asset or liability's classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

**Valuation Techniques.** Assets and liabilities carried at fair value and measured on a recurring basis as of June 30, 2014 consist of forward foreign exchange contracts. The Company values its forward foreign exchange contracts using quoted prices for similar assets. The most significant assumption is quoted currency rates. The value of the forward foreign exchange contract assets and liabilities were determined within Level 2 of the valuation hierarchy and are listed in the table above.

The carrying amounts reported in our consolidated condensed balance sheets for cash and cash equivalents, accounts receivable, accounts payable and long-term debt approximate fair value.

## Note 5 - Inventories

Inventories consist of the following:

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	December 31, 2013	June 30, 2014
Raw materials	\$39,029	\$47,061
Work-in-process	14,736	15,898
Finished goods	89,446	94,047
Total	\$143,211	\$157,006

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## Note 6 – Earnings Per Share

Basic earnings per share (“basic EPS”) is computed by dividing net income by the weighted average number of common shares outstanding for the reporting period. Diluted earnings per share (“diluted EPS”) gives effect to all dilutive potential shares outstanding resulting from employee stock options, restricted stock units, performance share units and stock appreciation rights (“SARs”) during the period. The following table sets forth the computation of basic and diluted earnings per share for the three and six months ended June 30, 2013 and 2014.

	Three Months Ended		Six Months Ended June	
	June 30, 2013	2014	30, 2013	2014
Net income	\$9,533	\$10,255	\$20,025	\$18,881
Basic – weighted average shares outstanding	27,591	27,257	27,860	27,303
Effect of dilutive potential securities	392	496	398	500
Diluted – weighted average shares outstanding	27,983	27,753	28,258	27,803
Net income				
Basic (per share)	\$0.35	\$0.38	\$0.72	\$0.69
Diluted (per share)	0.34	0.37	0.71	0.68

The shares used in the calculation of diluted EPS exclude options and SARs to purchase shares where the exercise price was greater than the average market price of common shares for the period. Shares excluded from the calculation of diluted EPS aggregated 0.1 million and 0.0 million for the three months ended June 30, 2013 and 2014, respectively. Shares excluded from the calculation of diluted EPS aggregated 0.1 million and 0.0 million for the six months ended June 30, 2013 and 2014, respectively.

## Note 7 – Goodwill and Other Intangible Assets

The changes in the net carrying amount of goodwill for the six months ended June 30, 2014 are as follows:

Balance as of December 31, 2013	\$248,428
Foreign currency translation	(1 )
Balance as of June 30, 2014	\$248,427

Other intangible assets consist of the following:

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	December 31, 2013		June 30, 2014	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortized intangible assets:				
Customer relationships	\$ 135,690	\$(54,982 )	\$ 135,690	\$(57,363 )
Promotional, marketing & distribution rights	149,376	(12,000 )	149,376	(15,000 )
Patents and other intangible assets	53,903	(39,091 )	53,847	(40,200 )
Unamortized intangible assets:				
Trademarks and tradenames	86,544	—	86,544	—
	\$425,513	\$(106,073 )	\$425,457	\$(112,563 )

Customer relationships, trademarks, tradenames, patents and other intangible assets primarily represent allocations of purchase price to identifiable intangible assets of acquired businesses. Promotional, marketing and distribution rights represent intangible assets created under our Sports Medicine Joint Development and Distribution Agreement (the "JDDA") with Musculoskeletal Transplant Foundation ("MTF").

On January 3, 2012, the Company entered into the JDDA with MTF to obtain MTF's worldwide promotion rights with respect to allograft tissues within the field of sports medicine and related products. The initial consideration from the Company included a \$63.0 million up-front payment for the rights and certain assets, with an additional \$84.0 million contingently payable over a four year period depending on MTF meeting supply targets for tissue. On January 3, 2013 and January 3, 2014, we paid \$34.0 million and \$16.7 million, respectively, of the additional consideration; \$16.7 million of the additional consideration is due within the next fiscal year with the remainder due in 2016. The \$33.3 million related to the remaining contingent obligation as of June 30, 2014 is accrued in other current and other long term liabilities as we believe it is probable MTF will meet the supply targets.

Trademarks and tradenames were recognized principally in connection with the 1997 acquisition of Linvatec Corporation. We continue to market products, release new product and product extensions and maintain and promote these trademarks and tradenames in the marketplace through legal registration and such methods as advertising, medical education and trade shows. It is our belief that these trademarks and tradenames will generate cash flow for an indefinite period of time. Therefore, our trademarks and tradenames intangible assets are not amortized.

Amortization expense related to intangible assets which are subject to amortization totaled \$3,521 and \$7,009 in the three and six months ended June 30, 2013 and \$3,278 and \$6,490 in the three and six months ended June 30, 2014, respectively, and is included as a reduction of revenue (for amortization related to our promotional, marketing and distribution rights) and in selling and administrative expense (for all other intangible assets) on the consolidated condensed statements of comprehensive income. The weighted average amortization period for intangible assets which are amortized is 27 years. Customer relationships are being amortized over a weighted average life of 33 years. Promotional, marketing and distribution rights are being amortized over a weighted average life of 25 years. Patents and other intangible assets are being amortized over a weighted average life of 14 years.

The estimated intangible asset amortization expense for the year ending December 31, 2014, including the six month period ended June 30, 2014 and for each of the five succeeding years is as follows:



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	Amortization included in expense	Amortization recorded as a reduction of revenue	Total
2014	\$7,019	\$6,000	\$13,019
2015	6,651	6,000	12,651
2016	6,519	6,000	12,519
2017	6,507	6,000	12,507
2018	6,450	6,000	12,450
2019	6,450	6,000	12,450

## Note 8 – Guarantees

We provide warranties on certain of our products at the time of sale. The standard warranty period for our capital and reusable equipment is generally one year. Liability under service and warranty policies is based upon a review of historical warranty and service claim experience. Adjustments are made to accruals as claim data and historical experience warrant.

Changes in the carrying amount of service and product warranties for the six months ended June 30, are as follows:

	2013	2014
Balance as of January 1,	\$3,636	\$2,422
Provision for warranties	1,814	1,736
Claims made	(2,178)	(1,815)
Balance as of June 30,	\$3,272	\$2,343

## Note 9 – Pension Plan

Net periodic pension (income) costs consist of the following:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2014	2013	2014
Service cost	\$69	\$72	\$138	\$145
Interest cost on projected benefit obligation	785	877	1,571	1,753
Expected return on plan assets	(1,302)	(1,496)	(2,604)	(2,992)
Net amortization and deferral	732	427	1,463	855
Net periodic pension (income) cost	\$284	\$(120)	\$568	\$(239)

We do not expect to make any pension contributions during 2014.

Note 10 – Other Expense

Other expense consists of the following:

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2014	2013	2014
Administrative consolidation costs	\$1,566	\$494	\$3,170	\$1,207
Costs associated with patent dispute, and other matters	527	1,410	736	3,304
Costs associated with shareholder activism	—	935	—	1,525
Other expense	\$2,093	\$2,839	\$3,906	\$6,036

During 2013 and 2014, we restructured certain administrative functions. For the three and six months ended June 30, 2013, we incurred \$1.6 million and \$3.2 million, respectively, in related costs and for the three and six months ended June 30, 2014 we incurred \$0.5 million and \$1.2 million, respectively, in related costs consisting principally of severance charges.

During the three and six months ended June 30, 2013, we incurred \$0.5 million and \$0.7 million, respectively, in legal costs associated with a patent infringement claim and for the three and six months ended June 30, 2014, we incurred \$0.0 million and \$1.9 million, respectively, including \$0.9 million in settlement costs during the first quarter of 2014 as further described in Note 12. In addition, the three and six months ended June 30, 2014 also included \$1.4 million in settlement costs, costs associated with a legal matter that we won and consulting fees.

During the three and six months ended June 30, 2014, we incurred \$0.9 million and \$1.5 million, respectively, in consulting and legal costs associated with shareholder activism.

## Note 11 — Business Segments

Our product lines consist of orthopedic surgery, general surgery and surgical visualization. Orthopedic surgery consists of sports medicine instrumentation and small bone, large bone and specialty powered surgical instruments and service fees related to the promotion and marketing of sports medicine allograft tissue. General surgery consists of a complete line of endo-mechanical instrumentation for minimally invasive laparoscopic and gastrointestinal procedures, a line of cardiac monitoring products as well as electrosurgical generators and related instruments. Surgical visualization consists of 2D and 3D video systems for use in minimally invasive orthopedic and general surgery. These product lines' net sales are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2014	2013	2014
Orthopedic surgery	\$101,853	\$102,362	\$206,867	\$208,310
General surgery	73,184	70,745	140,032	134,205
Surgical visualization	17,956	15,043	33,108	27,576
Consolidated net sales	\$192,993	\$188,150	\$380,007	\$370,091

## Note 12 – Legal Proceedings

From time to time, we are subject to claims alleging product liability, patent infringement, corrupt practices or other claims incurred in the ordinary course of business. These may involve our United States or foreign operations, or sales by foreign distributors. Likewise, from time to time, the Company may receive an information request or subpoena from a government agency such as the Securities and Exchange Commission, Department of Justice, Equal Employment Opportunity Commission, the Occupational Safety and Health Administration, the Department of Labor, the Treasury Department, or other federal and state agencies or foreign governments or government agencies. These

information requests or subpoenas may or may not be routine inquiries, or may begin as routine inquiries and over time develop into enforcement actions of various types. The product liability claims are generally covered by various insurance policies, subject to certain deductible amounts, maximum policy limits and certain exclusions in the respective policies or as required as a matter of law. In some cases we may be entitled to indemnification by third parties. We establish reserves sufficient to cover probable losses associated with claims. We do not expect that the resolution of any pending claims or investigations will have a material adverse effect on our financial condition, results of operations or cash flows. There can be no assurance, however, that future claims or investigations, or the costs associated with responding

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to such claims or investigations, especially claims and investigations not covered by insurance, will not have a material adverse effect on our financial condition, results of operations or cash flows.

Manufacturers of medical products may face exposure to significant product liability claims. To date, we have not experienced any product liability claims that have been material to our financial statements or financial condition, but any such claims arising in the future could have a material adverse effect on our business or results of operations. We currently maintain commercial product liability insurance of \$25 million per incident and \$25 million in the aggregate annually, which we believe is adequate. This coverage is on a claims-made basis. There can be no assurance that claims will not exceed insurance coverage, that the carriers will be solvent or that such insurance will be available to us in the future at a reasonable cost.

Our operations are subject, and in the past have been subject, to a number of environmental laws and regulations governing, among other things, air emissions, wastewater discharges, the use, handling and disposal of hazardous substances and wastes, soil and groundwater remediation and employee health and safety. In some jurisdictions environmental requirements may be expected to become more stringent in the future. In the United States certain environmental laws can impose liability for the entire cost of site restoration upon each of the parties that may have contributed to conditions at the site regardless of fault or the lawfulness of the party's activities. While we do not believe that the present costs of environmental compliance and remediation are material, there can be no assurance that future compliance or remedial obligations would not have a material adverse effect on our financial condition, results of operations or cash flows.

In September 2012, Bonutti Skeletal Innovations, LLC, an affiliate of Acacia Research Group, filed a complaint in the United States District Court for the Middle District of Florida against CONMED and certain of its subsidiaries. The Complaint asserts that select CONMED products infringe patents allegedly owned by Bonutti Skeletal Innovations. On the same day that it sued CONMED, Bonutti Skeletal Innovations sued several other orthopedic companies. The Company believed, and continues to believe, that the products in question do not infringe the patents-in-suit, and the Company vigorously defended the claims. In an order and decision dated March 25, 2014, the Court construed eight of the claims asserted in the case in a manner largely adverse to the plaintiff. In addition, on March 11 and March 28, 2014, the United States Patent Office granted CONMED's petitions for inter partes review with respect to two of the patents-in-suit. On April 3, 2014, CONMED and Acacia agreed to settle the claims for a payment by CONMED of \$0.9 million.

During the third quarter of 2013, the FDA inspected our Centennial, CO manufacturing facility and issued a Form 483 with observations on September 20, 2013. The Company subsequently submitted responses to the observations, and the FDA issued a Warning Letter on January 30, 2014 relating to the inspection and the responses to the Form 483 Observations. Accordingly, we are undertaking corrective actions that may involve additional costs for the Company. These remediation costs are not expected to be material, however there can be no assurance that the actions undertaken by the Company will ensure that the Company will not undertake recalls, voluntary or otherwise, nor can there be any assurance that a future inspection by the FDA will not result in an additional Form 483 or warning letter, or other regulatory actions which may include consent decrees or fines.

### Note 13 – New Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers." This ASU is a comprehensive new revenue recognition model that requires a company to recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration the company expects to receive in exchange for those goods or services. This ASU is effective for annual reporting periods beginning after December 15, 2016 and early adoption is not permitted. Accordingly, we will adopt this ASU on January 1, 2017. The new standard will become effective beginning with the first quarter 2017 and can be adopted



either retrospectively to each prior reporting period presented or as a cumulative effect adjustment as of the date of adoption. The Company is currently evaluating both the impact of adopting this new guidance on the consolidated financial statements and the method of adoption.

The Company does not believe there are any other new accounting pronouncements that would have a material impact on its financial position or results of operations.

Note 14 – Restructuring

We incurred the following restructuring costs:

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	Three Months Ended		Six Months Ended June	
	June 30,		30,	
	2013	2014	2013	2014
Restructuring costs included in cost of sales	\$1,606	\$1,358	\$3,228	\$2,306
Restructuring costs included in other expense	\$1,566	\$494	\$3,170	\$1,207

During 2013 and 2014, we continued our operational restructuring plan which includes the transfer of additional production lines from manufacturing facilities located in the United States to our manufacturing facility in Chihuahua, Mexico; the consolidation of our Finland operations into our Largo, Florida and Utica, New York manufacturing facilities; the consolidation of our Westborough, Massachusetts operations into our Largo, Florida and Chihuahua, Mexico facilities; and the consolidation of our Centennial, Colorado manufacturing operations into other existing CONMED manufacturing facilities. We believe the consolidation of our Finland and Westborough, Massachusetts operations are substantially complete and our Centennial, Colorado consolidation is to be completed over the next 18 months. We incurred \$1.6 million and \$3.2 million in costs associated with the operational restructuring during the three and six months ended June 30, 2013, respectively. We incurred \$1.4 million and \$2.3 million in costs associated with the operational restructuring during the three and six months ended June 30, 2014, respectively. These costs were charged to cost of goods sold and include severance and other charges associated with the transfer of production to Mexico and consolidation of our Finland, Westborough, Massachusetts and Centennial, Colorado operations.

Restructuring costs included in other expense are described more fully in Note 10.

We have recorded an accrual in current liabilities of \$2.3 million at June 30, 2014 mainly related to severance and lease impairment costs associated with the restructuring. Below is a rollforward of the accrual:

Balance as of January 1, 2014	\$3,128
Expenses incurred	1,016
Payments made	(1,885 )
Balance at June 30, 2014	\$2,259

## Note 15 - Income Taxes

A provision for income taxes has been recorded at an effective tax rate of 37.5% for the six months ended June 30, 2014 compared to the 29.8% effective tax rate recorded in the same period a year ago due to tax legislation changes. In New York State, corporate tax reform enacted in March 2014 changed the tax rate of a manufacturing company such as CONMED to essentially 0%. While this will be positive for the future, previously recorded New York State deferred tax assets of \$2.3 million that would have been used to offset taxes otherwise payable, no longer have value due to a zero percent tax rate. Accordingly, we have written off these New York State tax assets as a non-cash charge to income tax expense. The effective tax rate is also higher for the six months ended June 30, 2014 compared to the same period a year ago due to legislation enacted in the six months ended June 30, 2013 that retroactively reinstated the 2012 federal research and development credit (\$0.8 million).

## Note 16 - Subsequent Events

Effective July 23, 2014, there were a number of changes within our Board of Directors and Chief Executive Officer position as further described in our Form 8-K filing on July 23, 2014. We expect to incur \$9.5 million to \$11.0 million in charges related to these changes during the third quarter of 2014.

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Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION  
AND RESULTS OF OPERATIONS

Forward-Looking Statements

In this Report on Form 10-Q, we make forward-looking statements about our financial condition, results of operations and business. Forward-looking statements are statements made by us concerning events that may or may not occur in the future. These statements may be made directly in this document or may be "incorporated by reference" from other documents. Such statements may be identified by the use of words such as "anticipates", "expects", "estimates", "intends" and "believes" and variations thereof and other terms of similar meaning.

Forward-Looking Statements are not Guarantees of Future Performance

Forward-looking statements involve known and unknown risks, uncertainties and other factors, including those that may cause our actual results, performance or achievements, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors include those identified under "Risk Factors" in our Annual Report on Form 10-K for the year-ended December 31, 2013 and the following, among others:

- general economic and business conditions;
- changes in foreign exchange and interest rates;
- cyclical customer purchasing patterns due to budgetary and other constraints;
- changes in customer preferences;
- competition;
- changes in technology;
- the introduction and acceptance of new products;
- the ability to evaluate, finance and integrate acquired businesses, products and companies;
- changes in business strategy;
- the availability and cost of materials;
- the possibility that United States or foreign regulatory and/or administrative agencies may initiate enforcement actions against us or our distributors;
- future levels of indebtedness and capital spending;
- quality of our management and business abilities and the judgment of our personnel;
- the availability, terms and deployment of capital;
- the risk of litigation, especially patent litigation as well as the cost associated with patent and other litigation;
- the risk of a lack of allograft tissue due to reduced donations of such tissues or due to tissues not meeting the appropriate high standards for screening and/or processing of such tissues; and
- changes in regulatory requirements.

See "Management's Discussion and Analysis of Financial Condition and Results of Operations" below and "Risk Factors" and "Business" in our Annual Report on Form 10-K for the year-ended December 31, 2013 for a further discussion of these factors. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. We do not undertake any obligation to publicly release any revisions to these forward-looking statements to reflect events or circumstances after the date of this Quarterly Report on Form 10-Q or to reflect the occurrence of unanticipated events.

Overview:

CONMED Corporation (“CONMED”, the “Company”, “we” or “us”) is a medical technology company with an emphasis on surgical devices and equipment for minimally invasive procedures and monitoring. The Company’s products are used by surgeons and physicians in a variety of specialties including orthopedics, general surgery, gynecology and gastroenterology. These product lines as a percentage of consolidated net sales are as follows:

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	Three Months Ended June 30,		Six Months Ended June 30,		
	2013	2014	2013	2014	
Orthopedic surgery	52.8	% 54.4	% 54.5	% 56.3	%
General surgery	37.9	% 37.6	% 36.8	% 36.3	%
Surgical visualization	9.3	% 8.0	% 8.7	% 7.4	%
Consolidated net sales	100.0	% 100.0	% 100.0	% 100.0	%

A significant amount of our products are used in surgical procedures with the majority of our revenues derived from the sale of single-use products. Our capital equipment offerings also facilitate the ongoing sale of related disposable products and accessories, thus providing us with a recurring revenue stream. We manufacture substantially all of our products in facilities located in the United States and Mexico. We market our products both domestically and internationally directly to customers and through distributors. International sales represent a significant portion of our business. During the three and six months ended June 30, 2014 international sales approximated 53.4% and 52.7%, respectively, of total net sales.

#### Business Environment and Opportunities

The aging of the worldwide population along with lifestyle changes, continued cost containment pressures on healthcare systems and the desire of clinicians and administrators to use less invasive (or noninvasive) procedures are important trends which are driving the long-term growth in our industry. We believe that with our broad product offering of high quality surgical and patient care products, we can capitalize on this growth for the benefit of the Company and our shareholders.

In order to further our growth prospects, we have historically used strategic business acquisitions and exclusive distribution relationships to continue to diversify our product offerings, increase our market share and realize economies of scale.

We have a variety of research and development initiatives focused in each of our principal product lines as continued innovation and commercialization of new proprietary products and processes are essential elements of our long-term growth strategy. Our reputation as an innovator is exemplified by recent new product introductions such as the Y-Knot® Flex System for instability repairs featuring the smallest double-loaded (1.8mm) anchors available and curved, flexible instrumentation to help surgeons achieve ideal anchor placement and the Y-Knot® RC anchors for rotator cuffs are the world's only self-punching all-suture anchors which helps simplify techniques while its small size is designed to improve placement options; the new D4000 Resection System featuring an intuitive touchscreen display and direct pump integration for a seamless clinical experience; the IM8000 2DHD Camera System can be used in multi-specialty procedures and includes a new autoclavable camera head featuring proprietary CMOS technology for clear, crisp imagery and a new LS8000 LED light source providing improved light sensitivity for clearer visualization; the new Hall 50™ Powered Instrument System can be used in total joint replacements featuring lighter, ergonomically-designed handpieces to provide a comfortable, high-performance clinical experience while the new Hall UL-approved autoclavable lithium batteries deliver dependable, long-lasting power and the unique, multi-tray system also provides hospitals with new levels of sterilization convenience; the new Edge Ablation System is our bi-polar radio frequency arthroscopic energy system offers a versatile, intuitive design and user interface for arthroscopic ablation, coagulation and dissection; the new GS2000 50L Insufflator features the market's fastest flow rate and a dual-tank shuttle valve system to help provide clear and consistent laparoscopic visualization; the EntriPort line of trocars help deliver effective sealing and clear visualization in a wide range of sizes optimal for nearly every minimally invasive abdominal surgical application; our new D-Flex probes were designed for use with the da Vinci® Surgical System and enable non-contact hemostasis with argon gas and our DetachaTip® III Multi-Use Endosurgery

Instruments offer the optimal blend of performance and cost efficiency - combining precise, reliable, and comfortable performance with dramatically reduced procedural costs.

#### Business Challenges

Significant volatility in the financial markets and foreign currency exchange rates as well as depressed economic conditions in both domestic and international markets, have presented significant business challenges since the second half of 2008. While we returned to revenue growth in 2011 and 2012, we experienced a sales decline during 2013 and the first half of 2014. We are cautiously optimistic that the world's economic environment is improving, but there can be no assurance that improvement in the overall economic environment will be sustained. We will continue to monitor and manage the impact of the overall economic environment on the Company.

Over the past few years we successfully completed certain of our operational restructuring plans whereby we consolidated

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manufacturing and distribution centers as well as restructured certain of our administrative functions. We continue to restructure both operations and administrative functions as necessary throughout the organization. However, we cannot be certain such activities will be completed in the estimated time period or that planned cost savings will be achieved.

Our facilities are subject to periodic inspection by the United States Food and Drug Administration (“FDA”) and foreign regulatory agencies or notified bodies for, among other things, conformance to Quality System Regulation and Current Good Manufacturing Practice (“CGMP”) requirements and foreign or international standards. We are committed to the principles and strategies of systems-based quality management for improved CGMP compliance, operational performance and efficiencies through our Company-wide quality systems initiatives. However, there can be no assurance that our actions will ensure that we will not receive a warning letter or be the subject of other regulatory action, which may include consent decrees or fines, that we will not conduct product recalls or that we will not experience temporary or extended periods during which we may not be able to sell products in foreign countries. During the third quarter of 2013, the FDA inspected our Centennial, CO manufacturing facility and issued a Form 483 with observations on September 20, 2013. The Company subsequently submitted responses to the observations, and the FDA issued a Warning Letter on January 30, 2014 relating to the inspection and the responses to the Form 483 Observations. Accordingly, we are undertaking corrective actions that may involve additional costs for the Company. These remediation costs are not expected to be material, however there can be no assurance that the actions undertaken by the Company will ensure that the Company will not undertake recalls, voluntary or otherwise, nor can there be any assurance that a future inspection by the FDA will not result in an additional Form 483 or warning letter, or other regulatory actions which may include consent decrees or fines.

## Critical Accounting Policies

Preparation of our financial statements requires us to make estimates and assumptions which affect the reported amounts of assets, liabilities, revenues and expenses. Note 1 to the Consolidated Financial Statements in our Annual Report on Form 10-K for the year-ended December 31, 2013 describes significant accounting policies used in preparation of the Consolidated Financial Statements. The most significant areas involving management judgments and estimates are described below and are considered by management to be critical to understanding the financial condition and results of operations of CONMED Corporation. There have been no significant changes in our critical accounting estimates during the six months ended June 30, 2014.

## Revenue Recognition

Revenue is recognized when title has been transferred to the customer which is at the time of shipment. The following policies apply to our major categories of revenue transactions:

Sales to customers are evidenced by firm purchase orders. Title and the risks and rewards of ownership are transferred to the customer when product is shipped under our stated shipping terms. Payment by the customer is due under fixed payment terms and collectability is reasonably assured.

We place certain of our capital equipment with customers on a loaned basis in return for commitments to purchase related single-use products over time periods generally ranging from one to three years. In these circumstances, no revenue is recognized upon capital equipment shipment as the equipment is loaned and subject to return if certain minimum single-use purchases are not met. Revenue is recognized upon the sale and shipment of the related single-use products. The cost of the equipment is amortized over its estimated useful life.

We recognize revenues related to the promotion and marketing of sports medicine allograft tissue in accordance with the contractual terms of our agreement with Musculoskeletal Transplant Foundation (“MTF”) on a net basis as our role



is limited to that of an agent earning a commission or fee. MTF records revenue when the tissue is shipped to the customer. Our services are completed at this time and net revenues for the “Service Fee” for our promotional and marketing efforts are then recognized based on a percentage of the net amounts billed by MTF to its customers. The timing of revenue recognition is determined through review of the net billings made by MTF each month. Our net commission Service Fee is based on the contractual terms of our agreement and is currently 50%. This percentage can vary over the term of the agreement but is contractually determinable. Our Service Fee revenues are recorded net of amortization of the acquired assets, which are being expensed over the expected useful life of 25 years.

Product returns are only accepted at the discretion of the Company and in accordance with our “Returned Goods Policy”. Historically the level of product returns has not been significant. We accrue for sales returns, rebates and allowances based upon an analysis of historical customer returns and credits, rebates, discounts and current market conditions.

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Our terms of sale to customers generally do not include any obligations to perform future services. Limited warranties are provided for capital equipment sales and provisions for warranty are provided at the time of product sale based upon an analysis of historical data.

Amounts billed to customers related to shipping and handling have been included in net sales. Shipping and handling costs are included in selling and administrative expense.

We sell to a diversified base of customers around the world and, therefore, believe there is no material concentration of credit risk.

We assess the risk of loss on accounts receivable and adjust the allowance for doubtful accounts based on this risk assessment. Historically, losses on accounts receivable have not been material. Management believes that the allowance for doubtful accounts of \$1.4 million at June 30, 2014 is adequate to provide for probable losses resulting from accounts receivable.

## Inventory Valuation

We write-off excess and obsolete inventory resulting from the inability to sell our products at prices in excess of current carrying costs. The markets in which we operate are highly competitive, with new products and surgical procedures introduced on an on-going basis. Such marketplace changes may result in our products becoming obsolete. We make estimates regarding the future recoverability of the costs of our products and record a provision for excess and obsolete inventories based on historical experience, expiration of sterilization dates and expected future trends. If actual product life cycles, product demand or acceptance of new product introductions are less favorable than projected by management, additional inventory write-downs may be required.

## Goodwill and Intangible Assets

We have a history of growth through acquisitions. Assets and liabilities of acquired businesses are recorded at their estimated fair values as of the date of acquisition. Goodwill represents costs in excess of fair values assigned to the underlying net assets of acquired businesses. Customer relationships, trademarks, tradenames, patents, and other intangible assets primarily represent allocations of purchase price to identifiable intangible assets of acquired businesses. Promotional, marketing and distribution rights represent intangible assets created under our Sports Medicine Joint Development and Distribution Agreement (the "JDDA") with Musculoskeletal Transplant Foundation ("MTF"). We have accumulated goodwill of \$248.4 million and other intangible assets of \$312.9 million as of June 30, 2014.

In accordance with FASB guidance, goodwill and intangible assets deemed to have indefinite lives are not amortized, but are subject to at least annual impairment testing. It is our policy to perform our annual impairment testing in the fourth quarter. The identification and measurement of goodwill impairment involves the estimation of the fair value of our business. Estimates of fair value are based on the best information available as of the date of the assessment, which primarily incorporate management assumptions about expected future cash flows and other valuation techniques. Future cash flows may be affected by changes in industry or market conditions or the rate and extent to which anticipated synergies or cost savings are realized with newly acquired entities. During 2013, we completed our goodwill impairment testing with data as of October 1, 2013. We performed a Step 1 impairment test in accordance with ASC 350 utilizing the market capitalization approach to determine whether the fair value of a reporting unit is less than its carrying amount. Based upon our assessment, we believe the fair value continues to exceed carrying value by 99%.

Intangible assets with a finite life are amortized over the estimated useful life of the asset and are evaluated each reporting period to determine whether events and circumstances warrant a revision to the remaining period of

amortization. Intangible assets subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. The carrying amount of an intangible asset subject to amortization is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use of the asset. An impairment loss is recognized by reducing the carrying amount of the intangible asset to its current fair value.

Customer relationship assets arose principally as a result of the 1997 acquisition of Linvatec Corporation. These assets represent the acquisition date fair value of existing customer relationships based on the after-tax income expected to be derived during their estimated remaining useful life. The useful lives of these customer relationships were not and are not limited by contract or any economic, regulatory or other known factors. The estimated useful life of the Linvatec customer relationship assets was determined as of the date of acquisition as a result of a study of the observed pattern of historical revenue attrition during the 5 years immediately preceding the acquisition of Linvatec Corporation. This observed attrition pattern was then applied to the

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existing customer relationships to derive the future expected useful life of the customer relationships. This analysis indicated an annual attrition rate of 2.6%. Assuming an exponential attrition pattern, this equated to an average remaining useful life of approximately 38 years for the Linvatec customer relationship assets. Customer relationship intangible assets arising as a result of other business acquisitions are being amortized over a weighted average life of 16 years. The weighted average life for customer relationship assets in aggregate is 33 years.

We evaluate the remaining useful life of our customer relationship intangible assets each reporting period in order to determine whether events and circumstances warrant a revision to the remaining period of amortization. In order to further evaluate the remaining useful life of our customer relationship intangible assets, we perform an analysis and assessment of actual customer attrition and activity as events and circumstances warrant. This assessment includes a comparison of customer activity since the acquisition date and review of customer attrition rates. In the event that our analysis of actual customer attrition rates indicates a level of attrition that is in excess of that which was originally contemplated, we would change the estimated useful life of the related customer relationship asset with the remaining carrying amount amortized prospectively over the revised remaining useful life.

We test our customer relationship assets for recoverability whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Factors specific to our customer relationship assets which might lead to an impairment charge include a significant increase in the annual customer attrition rate or otherwise significant loss of customers, significant decreases in sales or current-period operating or cash flow losses or a projection or forecast of losses. We do not believe that there have been events or changes in circumstances which would indicate the carrying amount of our customer relationship assets might not be recoverable.

For all other indefinite lived intangible assets, we perform a qualitative impairment test in accordance with ASC 350. Based upon this assessment as of October 1, 2013, we have determined that it is unlikely that our indefinite lived intangible assets are impaired.

## Pension Plan

We sponsor a defined benefit pension plan (the "pension plan") that was frozen in 2009. It covered substantially all our United States based employees at the time it was frozen. Major assumptions used in accounting for the plan include the discount rate, expected return on plan assets, rate of increase in employee compensation levels and expected mortality. Assumptions are determined based on Company data and appropriate market indicators, and are evaluated annually as of the plan's measurement date. A change in any of these assumptions would have an effect on net periodic pension costs reported in the consolidated financial statements.

The weighted-average discount rate used to measure pension liabilities and costs is set by reference to the Citigroup Pension Liability Index. However, this index gives only an indication of the appropriate discount rate because the cash flows of the bonds comprising the index do not match precisely the projected benefit payment stream of the plan. For this reason, we also consider the individual characteristics of the plan, such as projected cash flow patterns and payment durations, when setting the discount rate. The rates used in determining 2013 and 2014 pension expense are 3.90% and 4.75%, respectively.

We have used an expected rate of return on pension plan assets of 8.0% for purposes of determining the net periodic pension benefit cost. In determining the expected return on pension plan assets, we consider the relative weighting of plan assets, the historical performance of total plan assets and individual asset classes and economic and other indicators of future performance. In addition, we consult with financial and investment management professionals in developing appropriate targeted rates of return.

For the three and six months ending June 30, 2014 we recorded pension income of \$0.1 million and \$0.2 million, respectively. Pension income in 2014 is expected to be \$0.5 million compared to expense of \$2.6 million in 2013. We do not expect to make any contributions during 2014.

See Note 9 to the Consolidated Condensed Financial Statements for further discussion.

#### Stock Based Compensation

All share-based payments to employees, including grants of employee stock options, restricted stock units, performance share units and stock appreciation rights are recognized in the financial statements based at their fair values. Compensation expense is generally recognized using a straight-line method over the vesting period. Compensation expense for performance share units is recognized using the graded vesting method.

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## Income Taxes

The recorded future tax benefit arising from deductible temporary differences and tax carryforwards is approximately \$33.0 million at June 30, 2014. Management believes that earnings during the periods when the temporary differences become deductible will be sufficient to realize the related future income tax benefits.

The Company is subject to taxation in the United States and various states and foreign jurisdictions. Taxing authority examinations can involve complex issues and may require an extended period of time to resolve. Our Federal income tax returns have been examined by the Internal Revenue Service (“IRS”) for calendar years ending through 2012. Tax years subsequent to 2012 are subject to future examination.

## Results of Operations

The following table presents, as a percentage of net sales, certain categories included in our consolidated condensed statements of income for the periods indicated:

	Three Months Ended June 30, 2013		Six Months Ended June 30, 2013		2014	
Net sales	100.0	% 100.0	% 100.0	% 100.0	% 100.0	%
Cost of sales	46.7		46.3	45.9	45.0	
Gross profit	53.3		53.7	54.1	55.0	
Selling and administrative expense	40.0		39.3	40.8	40.0	
Research and development expense	3.4		3.7	3.2	3.7	
Medical device excise tax	0.7		0.7	0.8	0.7	
Other expense	1.1		1.5	1.0	1.6	
Income from operations	8.1		8.5	8.3	9.0	
Loss on early extinguishment of debt	—		—	0.1	—	
Interest expense	0.7		0.8	0.7	0.8	
Income before income taxes	7.4		7.7	7.5	8.2	
Provision for income taxes	2.5		2.2	2.2	3.1	
Net income	4.9	% 5.5	% 5.3	% 5.1	%	%

Quarter ended June 30, 2014 compared to quarter ended June 30, 2013

Sales for the quarter ended June 30, 2014 were \$188.2 million, a decrease of \$4.8 million (-2.5%) compared to sales of \$193.0 million in the same period a year ago with decreases in the visualization and general surgery product lines. In local currency, excluding the effects of the hedging program, sales decreased 2.3%. Sales of capital equipment decreased \$1.2 million (-3.1%) to \$38.0 million in the quarter ended June 30, 2014 from \$39.2 million in the same period a year ago; sales of single-use products decreased \$3.6 million (-2.3%) to \$150.2 million in the quarter ended June 30, 2014 from \$153.8 million in the same period a year ago. On a local currency basis, excluding the effects of our hedging program, sales of capital equipment decreased 3.1% and single-use products decreased 2.1%.

Orthopedic surgery sales increased \$0.6 million (0.6%) in the quarter ended June 30, 2014 to \$102.4 million from \$101.8 million in the same period a year ago mainly due to higher sales in our soft tissue fixation products and powered surgical products, offset by the discontinuation of the Cascade PRP product line. In local currency, excluding the effects of the hedging program, sales increased 0.8%.

General surgery sales decreased \$2.5 million (-3.4%) in the quarter ended June 30, 2014 to \$70.7 million from \$73.2 million in the same period a year ago mainly due to lower sales in our advanced energy, endomechanical and patient monitoring products. In local currency, excluding the effects of the hedging program, sales decreased 3.2%.

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Surgical visualization sales decreased \$2.9 million (-16.1%) in the quarter ended June 30, 2014 to \$15.1 million from \$18.0 million in the same period a year ago as we believe customers are awaiting the release of our new IM8000 2DHD camera system. In local currency, excluding the effects of the hedging program, sales decreased 16.1%.

Cost of sales decreased to \$87.1 million in the quarter ended June 30, 2014 as compared to \$90.1 million in the same period a year ago. Gross profit margins increased 0.4 percentage points to 53.7% in the quarter ended June 30, 2014 as compared to 53.3% in the same period a year ago. The increase in gross profit margins of 0.4 percentage points is primarily a result of the lower costs resulting from the restructuring initiatives we have completed throughout our operations.

Selling and administrative expense decreased to \$74.0 million in the quarter ended June 30, 2014 as compared to \$77.2 million in the same period a year ago. Selling and administrative expense as a percentage of net sales decreased to 39.3% in the quarter ended June 30, 2014 as compared to 40.0% in the same period a year ago. The current quarter expense is consistent with historic spending levels.

Research and development expense increased to \$6.9 million in the quarter ended June 30, 2014 as compared to \$6.6 million in the same period a year ago. As a percentage of net sales, research and development expense increased to 3.7% in the quarter ended June 30, 2014 compared to 3.4% in the same period a year ago. The increase of 0.3 percentage points is mainly a result of the timing of development projects.

The medical device excise tax expense remained consistent at \$1.4 million in the quarter ended June 30, 2014 as compared to the same period a year ago.

As discussed in Note 10 to the Consolidated Condensed Financial Statements, other expense in the quarter ended June 30, 2014 consisted of a \$0.5 million charge related to administrative consolidation expenses; \$1.4 million in settlement costs, costs associated with a legal matter that we won, and consulting fees; and \$0.9 million in consulting costs related to shareholder activism. Other expense in the quarter ended June 30, 2013 consisted of a \$1.6 million charge related to administrative consolidation expenses and \$0.5 million in legal costs associated with a patent infringement claim as further described in Note 12.

Interest expense was \$1.6 million in the quarter ended June 30, 2014 compared to \$1.4 million in the same period a year ago. Interest expense increased due to the cost associated with higher weighted average borrowings in the quarter ended June 30, 2014 as compared to the same period a year ago. The weighted average interest rates on our borrowings increased to 2.49% in the quarter ended June 30, 2014 as compared to 2.29% in the same period a year ago.

A provision for income taxes has been recorded at an effective tax rate of 28.6% for the quarter ended June 30, 2014 compared to the 33.2% effective tax rate recorded in the same period a year ago due to favorable results and taxing authority settlements in connection with the prior year tax return finalization process. A reconciliation of the United States statutory income tax rate to our effective tax rate is included in our Annual Report on Form 10-K for the year-ended December 31, 2013, Note 6 to the Consolidated Financial Statements.

Six Months Ended June 30, 2014 compared to six months ended June 30, 2013

Sales for the six months ended June 30, 2014 were \$370.1 million, a decrease of \$9.9 million (-2.6%) compared to sales of \$380.0 million in the same period a year ago with decreases in the visualization and general surgery product lines. In local currency, excluding the effects of the hedging program, sales decreased 2.2%. Sales of capital equipment decreased \$4.9 million (-6.3%) to \$73.5 million in the six months ended June 30, 2014 from \$78.4 million in the same period a year ago; sales of single-use products decreased \$5.0 million (-1.7%) to \$296.6 million in the six



months ended June 30, 2014 from \$301.6 million in the same period a year ago. On a local currency basis, excluding the effects of the hedging program, sales of capital equipment decreased 6.0% while single-use products decreased 1.2%.

Orthopedic surgery sales increased \$1.4 million (0.7%) in the six months ended June 30, 2014 to \$208.3 million from \$206.9 million in the same period a year ago due higher sales of our soft tissue fixation products and powered surgical handpiece products, offset by the discontinuation of the Cascade PRP product line. In local currency, excluding the effects of the hedging program, sales increased 1.3%.

General surgery sales decreased \$5.8 million (-4.1%) in the six months ended June 30, 2014 to \$134.2 million from \$140.0 million in the same period a year ago due to lower sales in our advanced energy, endomechanical and patient monitoring products. In local currency, excluding the effects of the hedging program, sales decreased 3.9%.

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Surgical visualization sales decreased \$5.5 million (-16.6%) in the six months ended June 30, 2014 to \$27.6 million from \$33.1 million in the same period a year ago as we believe customers are awaiting the release of our new IM8000 2DHD camera system. In local currency, excluding the effects of the hedging program, sales decreased 16.6%.

Cost of sales decreased to \$166.5 million in the six months ended June 30, 2014 as compared to \$174.4 million in the same period a year ago. Gross profit margins increased 0.9 percentage points to 55.0% in the six months ended June 30, 2014 as compared to 54.1% in the same period a year ago primarily a result of the lower costs resulting from the restructuring initiatives we have completed throughout our operation.

Selling and administrative expense decreased to \$147.8 million in the six months ended June 30, 2014 as compared to \$154.9 million in the same period a year ago. Selling and administrative expense as a percentage of net sales decreased to 40.0% in the six months ended June 30, 2014 as compared to 40.8% in the same period a year ago. The current year to date expense is consistent with historic spending levels.

Research and development expense totaled \$13.8 million in the six months ended June 30, 2014 as compared to \$12.3 million in the same period a year ago. As a percentage of net sales, research and development expense increased to 3.7% in the six months ended June 30, 2014 compared to 3.2% in the same period a year ago. This increase of 0.5 percentage points is mainly a result of the timing of projects.

The medical device excise tax expense decreased to \$2.7 million in the six months ended June 30, 2014 as compared to \$3.0 million in the same period a year ago due to lower domestic sales subject to the tax.

As discussed in Note 10 to the Consolidated Condensed Financial Statements, other expense in the six months ended June 30, 2014 consisted of a \$1.2 million charge related to administrative consolidation expenses; \$1.9 million in legal and related settlement costs associated with a patent infringement claim as further described in Note 12; \$1.4 million in settlement costs, costs associated with a legal matter that we won, and consulting fees; and \$1.5 million in consulting costs related to shareholder activism. Other expense in the six months ended June 30, 2013 consisted of a \$3.2 million charge related to administrative consolidation expenses and \$0.7 million in legal costs associated with a patent infringement claim as further described in Note 12.

During the six months ended June 30, 2013, we recorded a \$0.3 million loss on early extinguishment of debt related to the write-off of unamortized deferred financing costs under the previously existing senior credit agreement.

Interest expense was \$3.0 million at June 30, 2014 as compared to \$2.7 million in the same period a year ago. Interest expense increased due to the cost associated with higher weighted average borrowings in the six months ended June 30, 2014 as compared to the same period a year ago. The weighted average interest rates on our borrowings increased to 2.43% in the six months ended June 30, 2014 as compared to 2.36% in the same period a year ago.

A provision for income taxes has been recorded at an effective tax rate of 37.5% for the six months ended June 30, 2014 compared to the 29.8% effective tax rate recorded in the same period a year ago due to tax legislation changes. In New York State, corporate tax reform enacted in March 2014 changed the tax rate of a manufacturing company such as CONMED to essentially 0%. While this will be positive for the future, previously recorded New York State deferred tax assets of \$2.3 million that would have been used to offset taxes otherwise payable, no longer have value due to a zero percent tax rate. Accordingly, we have written off these New York State tax assets as a non-cash charge to income tax expense. The effective tax rate is also higher for the six months ended June 30, 2014 compared to the same period a year ago due to legislation enacted in the six months ended June 30, 2013 that retroactively reinstated the 2012 federal research and development credit (\$0.8 million). A reconciliation of the United States statutory income tax rate to our effective tax rate is included in our Annual Report on Form 10-K for the year-ended December 31, 2013, Note 6 to the Consolidated Financial Statements.

## Liquidity and Capital Resources

Our liquidity needs arise primarily from capital investments, working capital requirements and payments on indebtedness under the amended and restated senior credit agreement, described below. We have historically met these liquidity requirements with funds generated from operations and borrowings under our revolving credit facility. In addition, we have historically used term borrowings, including borrowings under the amended and restated senior credit agreement and borrowings under separate loan facilities, in the case of real property purchases, to finance our acquisitions. We also have the ability to raise funds through the sale of stock or we may issue debt through a private placement or public offering. We believe that our cash on hand, cash from operating activities and proceeds from our amended and restated senior credit agreement provide us with sufficient financial resources to meet our anticipated capital requirements and obligations as they come due.

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### Operating cash flows

Our net working capital position was \$280.7 million at June 30, 2014. Net cash provided by operating activities was \$23.2 million and \$24.9 million in the six months ended June 30, 2013 and 2014, respectively, generated on net income of \$20.0 million and \$18.9 million for the six months ended June 30, 2013 and 2014, respectively.

Operating cash flow in 2014 was unfavorably impacted by higher inventory levels related partially to anticipated new products to be launched in the second half of 2014. Offsetting the cash usage for inventory in 2014 was lower pension funding due to a large contribution in 2013 that was not required in 2014.

### Investing cash flows

Net cash used in investing activities in the six months ended June 30, 2014 consisted of capital expenditures. Capital expenditures were \$8.2 million and \$8.6 million for the six months ended June 30, 2013 and 2014, respectively, and are expected to approximate \$20.0 million in 2014.

### Financing cash flows

Financing activities in the first six months of 2014 resulted in a use of cash of \$11.3 million compared to proceeds of cash of \$0.8 million in the same period a year ago. We had proceeds from the issuance of common stock under our equity compensation plans and employee stock purchase plan of \$1.0 million in 2014 compared to \$10.4 million in 2013. Dividend payments related to our common stock were \$11.0 million in 2014 compared to \$8.4 million in 2013. Cash from borrowings on our revolving credit facility under our amended and restated senior credit agreement were \$31.0 million in 2014 compared to \$73.0 million in 2013. These amounts were offset by lower repurchases of common stock totaling \$16.9 million in 2014 compared to \$44.7 million in 2013; and we made a \$16.7 million payment in 2014 compared to a \$34.0 million payment in 2013 associated with the distribution and development agreement with MTF.

On January 17, 2013, we entered into an amended and restated \$350.0 million senior credit agreement (the "amended and restated senior credit agreement"). The amended and restated senior credit agreement consists of a \$350.0 million revolving credit facility expiring on January 17, 2018. The amended and restated senior credit agreement was used to repay borrowings outstanding on the revolving credit facility under the then existing senior credit agreement. In connection with the refinancing, we recorded a \$0.3 million loss on the early extinguishment of debt related to the write-off of unamortized deferred financing costs under the then existing senior credit agreement. Interest rates are at LIBOR plus 1.50% (1.79% at June 30, 2014) or an alternative base rate. For those borrowings where we elect to use the alternative base rate, the base rate will be the greater of the Prime Rate, the Federal Funds Rate in effect on such date plus 0.50%, or the one month Eurocurrency rate plus 1%, plus an additional margin of 0.625%.

There were \$239.0 million in borrowings outstanding on the \$350.0 million revolving credit facility of the amended and restated senior credit agreement as of June 30, 2014. Our available borrowings on the revolving credit facility of the amended and restated senior credit agreement at June 30, 2014 were \$105.5 million with approximately \$5.5 million of the facility set aside for outstanding letters of credit.

The amended and restated senior credit agreement is collateralized by substantially all of our personal property and assets. The senior credit agreement contains covenants and restrictions which, among other things, require the maintenance of certain financial ratios, and restrict dividend payments and the incurrence of certain indebtedness and other activities, including acquisitions and dispositions. We were in full compliance with these covenants and restrictions as of June 30, 2014. We are also required, under certain circumstances, to make mandatory prepayments from net cash proceeds from any issuance of equity and asset sales.

We have a mortgage note outstanding in connection with the Largo, Florida property and facilities bearing interest at 8.25% per annum with semiannual payments of principal and interest through June 2019. The principal balance outstanding on the mortgage note aggregated \$7.0 million at June 30, 2014. The mortgage note is collateralized by the Largo, Florida property and facilities.

Our Board of Directors authorized a \$200.0 million share repurchase program. Through June 30, 2014, we have repurchased a total of 6.1 million shares of common stock aggregating \$162.6 million under this program and have \$37.4 million remaining available for share repurchases. The repurchase program calls for shares to be purchased in the open market or in private transactions from time to time. We may suspend or discontinue the share repurchase program at any time. We repurchased \$16.9 million under the share repurchase program during the first six months of 2014. We have financed the repurchases and may

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finance additional repurchases through operating cash flow and from available borrowings under our amended and restated senior credit agreement.

During 2012, the Board of Directors adopted a cash dividend policy. The \$0.20 per share dividend for the second quarter of 2014 was paid on July 7, 2014 to shareholders of record as of June 16, 2014. The total dividend payable at June 30, 2014 was \$5.5 million and is included in other current liabilities in the consolidated condensed balance sheet.

Management believes that cash flow from operations, including cash and cash equivalents on hand and available borrowing capacity under our amended and restated senior credit agreement, will be adequate to meet our anticipated operating working capital requirements, debt service, funding of capital expenditures and common stock repurchases in the foreseeable future.

### Restructuring

During 2013 and 2014, we continued our operational restructuring plan which includes the transfer of additional production lines from manufacturing facilities located in the United States to our manufacturing facility in Chihuahua, Mexico; the consolidation of our Finland operations into our Largo, Florida and Utica, New York manufacturing facilities; the consolidation of our Westborough, Massachusetts operations into our Largo, Florida and Chihuahua, Mexico facilities; and the consolidation of our Centennial, Colorado manufacturing operations into other existing CONMED manufacturing facilities. We believe the consolidation of our Finland and Westborough, Massachusetts operations are substantially complete and our Centennial, Colorado consolidation is to be completed over the next 18 months. We incurred \$1.6 million and \$3.2 million in costs associated with the operational restructuring during the three and six months ended June 30, 2013, respectively and incurred \$1.4 million and \$2.3 million in costs associated with restructuring during the three and six months ended June 30, 2014, respectively. These costs were charged to cost of goods sold and include severance and other charges associated with the transfer of production to Mexico and consolidation of our Finland, Westborough, Massachusetts and Centennial, Colorado operations.

During 2013 and 2014, we restructured certain administrative functions throughout the Company. For the three and six months ended June 30, 2013 we incurred \$1.6 million and \$3.2 million, respectively, in related costs and for the three and six months ended June 30, 2014 we incurred \$0.5 million and \$1.2 million, respectively, in related costs consisting principally of severance charges. These costs were charged to other expense.

We have recorded an accrual in current liabilities of \$2.3 million at June 30, 2014 mainly related to severance and lease impairment costs associated with the restructuring.

We plan to continue to restructure both operations and administrative functions as necessary throughout the organization. As the restructuring plan progresses, we will incur additional charges, including employee termination costs and other exit costs. We estimate restructuring costs will approximate \$3.5 million to \$4.5 million for the remainder of 2014 on consolidation projects which will be recorded to cost of goods sold and other expense. We also expect to incur \$9.5 million to \$11.0 million in executive transition charges which will be recorded to other expense as further described in Note 16.

See Note 14 to the Consolidated Condensed Financial Statements for further discussions regarding restructuring.

### New accounting pronouncements

See Note 13 to the Consolidated Condensed Financial Statements for a discussion of new accounting pronouncements.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no significant changes in our primary market risk exposures or in how these exposures are managed during the six months ended June 30, 2014. Reference is made to Item 7A. of our Annual Report on Form 10-K for the year-ended December 31, 2013 for a description of Qualitative and Quantitative Disclosures About Market Risk.

Item 4. Controls and Procedures

An evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended ("Exchange Act")) was carried out under the supervision and with the participation of the Company's management, including the Interim Chief Executive Officer and the Executive Vice President, Finance and Chief Financial Officer ("the Certifying Officers") as of June 30, 2014. Based on that evaluation, the Certifying Officers concluded that the Company's disclosure controls and procedures are effective. There have been no changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and

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15d-15(f) under the Exchange Act) during the quarter ended June 30, 2014 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

Reference is made to Item 3 of the Company's Annual Report on Form 10-K for the year-ended December 31, 2013 and to Note 12 of the Notes to Consolidated Condensed Financial Statements included in Part I of this Report for a description of certain legal matters.

Item 6. Exhibits

Exhibit No. Description of Exhibit

- |      |   |
|------|---|
| 31.1 | Certification of Curt R. Hartman pursuant to Rule 13a-14(a) or Rule 15d-14(a), of the Securities Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 31.2 | Certification of Robert D. Shallish, Jr. pursuant to Rule 13a-14(a) or Rule 15d-14(a), of the Securities Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 32.1 | Certification of Curt R. Hartman and Robert D. Shallish, Jr. pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code)  |
| 101  | The following materials from CONMED Corporation's Quarterly Report on Form 10-Q for the three and six months ended June 30, 2014 formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Condensed Statements of Comprehensive Income for the three and six months ended June 30, 2013 and 2014, (ii) the Consolidated Condensed Balance Sheets at December 31, 2013 and June 30, 2014, (iii) Consolidated Condensed Statements of Cash Flows for the six months ended June 30, 2013 and 2014, and (iv) Notes to Consolidated Condensed Financial Statements for the six months ended June 30, 2014. In accordance with Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be "filed" for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be part of any registration statement or other document filed under the Securities Act or the Exchange Act, except as shall be expressly set forth by specific reference in such filing. |



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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CONMED CORPORATION  
(Registrant)

Date: July 25, 2014

/s/ Robert D. Shallish, Jr.  
Robert D. Shallish, Jr.  
Executive Vice President, Finance and  
Chief Financial Officer

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## Exhibit Index

Exhibit	Sequential Page Number
31.1	E-1
<p>Certification of Curt R. Hartman pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</p>	
31.2	E-2
<p>Certification of Robert D. Shallish, Jr. pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</p>	
32.1	E-3
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