IDEXX LABORATORIES INC /DE
Form 10-Q
April 24, 2009

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2009

OR

o **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: 0-19271

IDEXX LABORATORIES, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**01-0393723**
(State or other jurisdiction of incorporation or organization)	*(IRS Employer Identification No.)*
ONE IDEXX DRIVE, WESTBROOK, MAINE	**04092**
(Address of principal executive offices)	*(ZIP Code)*

207-556-0300

(Registrant s telephone number, including area code)

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

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

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

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

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date. The number of shares outstanding of the registrant s Common Stock, $0.10 par value, was 59,013,088 on April 20, 2009.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

IDEXX LABORATORIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except per share amounts)
(Unaudited)

	March 31, 2009	December 31, 2008
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 86,295	$ 78,868
Accounts receivable, less reserves of $2,124 in 2009 and $2,093 in 2008	115,253	111,498
Inventories	123,575	115,926
Deferred income tax assets, net	20,915	21,477
Other current assets	21,745	28,121
Total current assets	367,783	355,890
Property and equipment, net	186,708	189,646
Goodwill and other intangible assets, net	200,748	207,095
Other long-term assets, net	15,265	12,806
	216,013	219,901
TOTAL ASSETS	$ 770,504	$ 765,437
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 23,541	$ 28,006
Accrued expenses	29,482	32,857
Accrued employee compensation and related expenses	28,051	43,252
Accrued taxes	17,751	13,324
Accrued customer programs	16,193	15,183
Short-term debt	165,517	150,620
Current portion of long-term debt	777	765
Deferred revenue	10,831	11,285
Total current liabilities	292,143	295,292
Long-term Liabilities:		
Deferred tax liabilities	12,339	11,933
Long-term debt, net of current portion	4,896	5,094
Deferred revenue	3,822	3,787
Other long-term liabilities	11,476	11,137
Total long-term liabilities	32,533	31,951

Commitments and Contingencies (Note 12)				
Stockholders Equity:				
Common stock, $0.10 par value: Authorized: 120,000 shares; Issued: 95,630 and 95,387 shares in 2009 and 2008, respectively		9,563		9,539
Additional paid-in capital		553,446		547,692
Deferred stock units: Outstanding: 113 and 102 units in 2009 and 2008, respectively		4,146		3,647
Retained earnings		728,102		702,031
Accumulated other comprehensive income (loss)		(2,981)		5,675
Treasury stock, at cost: 36,662 and 36,164 shares in 2009 and 2008, respectively		(846,448)		(830,390)
Total stockholders equity		445,828		438,194
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$	770,504	$	765,437

The accompanying notes are an integral part of these condensed consolidated financial statements.

IDEXX LABORATORIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts)
(Unaudited)

	For the Three Months Ended March 31, 2009	For the Three Months Ended March 31, 2008
Revenue:		
Product revenue	$ 155,895	$ 168,990
Service revenue	80,560	80,084
	236,455	249,074
Cost of Revenue:		
Cost of product revenue	59,267	64,541
Cost of service revenue	52,755	54,697
	112,022	119,238
Gross profit	124,433	129,836
Expenses:		
Sales and marketing	40,985	44,001
General and administrative	29,068	29,821
Research and development	15,939	17,295
Income from operations	38,441	38,719
Interest expense	(640)	(1,031)
Interest income	244	546
Income before provision for income taxes	38,045	38,234
Provision for income taxes	11,974	10,683
Net income	$ 26,071	$ 27,551
Earnings per Share:		
Basic	$ 0.44	$ 0.45
Diluted	$ 0.43	$ 0.43
Weighted Average Shares Outstanding:		
Basic	59,172	60,865
Diluted	60,606	63,558

The accompanying notes are an integral part of these condensed consolidated financial statements.

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IDEXX LABORATORIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(Unaudited)

	For the Three Months Ended March 31, 2009	2008
Cash Flows from Operating Activities:		
Net income	$ 26,071	$ 27,551
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Depreciation and amortization	13,047	11,395
Decrease in deferred compensation expense	(100)	(131)
Provision for uncollectible accounts	246	523
Provision for (benefit of) deferred income taxes	1,465	(999)
Share-based compensation expense	2,930	2,878
Tax benefit from exercises of stock options and vesting of restricted stock units	(161)	(2,384)
Changes in assets and liabilities, net of acquisitions:		
Accounts receivable	(6,072)	(13,543)
Inventories	(8,067)	(477)
Other assets	179	(530)
Accounts payable	(4,315)	(7,539)
Accrued liabilities	(12,394)	(19,200)
Deferred revenue	(205)	(333)
Net cash provided (used) by operating activities	12,624	(2,789)
Cash Flows from Investing Activities:		
Purchases of property and equipment	(9,114)	(17,049)
Proceeds from disposition of pharmaceutical product lines	1,377	
Proceeds from sale of property and equipment	1,046	
Acquisitions of equipment leased to customers	(188)	(226)
Acquisitions of intangible assets and businesses, net of cash acquired		(7,533)
Net cash used by investing activities	(6,879)	(24,808)
Cash Flows from Financing Activities:		
Borrowings on revolving credit facilities, net	15,019	67,942
Payment of other notes payable	(190)	(177)
Purchase of treasury stock	(14,986)	(51,355)
Proceeds from exercises of stock options and employee stock purchase plans	3,281	5,974
Tax benefit from exercises of stock options and vesting of restricted stock units	161	2,384
Net cash provided by financing activities	3,285	24,768
Net effect of exchange rates on cash	(1,603)	2,689
Net increase (decrease) in cash and cash equivalents	7,427	(140)

Cash and cash equivalents at beginning of period		78,868		60,360
Cash and cash equivalents at end of period	$	86,295	$	60,220
Supplemental Disclosures of Cash Flow Information:				
Interest paid	$	1,105	$	1,182
Income taxes paid	$	3,337	$	15,343

The accompanying notes are an integral part of these condensed consolidated financial statements.

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IDEXX LABORATORIES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1. BASIS OF PRESENTATION AND PRINCIPLES OF CONSOLIDATION

The accompanying unaudited, condensed consolidated financial statements of IDEXX Laboratories, Inc. (IDEXX, the Company, we or our) have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and with the requirements of Regulation S-X, Rule 10-01 for financial statements required to be filed as a part of Form 10-Q.

The accompanying unaudited, condensed consolidated financial statements include the accounts of IDEXX Laboratories, Inc. and our wholly-owned and majority-owned subsidiaries, and all other entities in which we have a variable interest and are determined to be the primary beneficiary. All material intercompany transactions and balances have been eliminated in consolidation.

The accompanying unaudited, condensed consolidated financial statements reflect, in the opinion of our management, all adjustments necessary for a fair statement of our financial position and results of operations. The condensed balance sheet data at December 31, 2008 was derived from audited financial statements, but does not include all disclosures required by U.S. GAAP. The results of operations for the three months ended March 31, 2009 are not necessarily indicative of the results to be expected for the full year or any future period. These unaudited, condensed consolidated financial statements should be read in conjunction with this Quarterly Report on Form 10-Q for the three months ended March 31, 2009, and our Annual Report on Form 10-K for the year ended December 31, 2008 filed with the Securities and Exchange Commission.

Certain reclassifications have been made to the prior year condensed consolidated financial statements to conform to the current year presentation. Reclassifications had no material impact on previously reported results of operations or financial position.

NOTE 2. ACCOUNTING POLICIES

Significant Accounting Policies

The significant accounting policies used in preparation of these condensed consolidated financial statements for the three months ended March 31, 2009 are consistent with those discussed in Note 3 to the consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2008.

Recent Accounting Pronouncements

We adopted the provisions of Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standard (SFAS) No. 141(R), Business Combinations (SFAS No. 141(R)), which revised SFAS No. 141, Business Combinations, on January 1, 2009. SFAS No. 141(R) establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS No. 141(R) also establishes disclosure requirements, which will enable users to evaluate the nature and financial effects of business combinations. Among other things, SFAS No. 141(R) expands the definitions of a business and business combination, requires recognition of contingent consideration at fair value on the acquisition date and requires acquisition-related transaction costs to be expensed as incurred. As the provisions of SFAS No. 141(R) are applied prospectively, there was no impact of adoption on our financial position, results of operations, or cash flows.

We adopted the provisions SFAS No. 157, Fair Value Measurements (SFAS No. 157) for nonfinancial assets and nonfinancial liabilities, which were previously deferred by FASB Staff Position (FSP) No. SFAS 157-2, Effective Date of FASB Statement No. 157 (FSP No. SFAS 157-2), on January 1, 2009. SFAS No. 157 establishes a framework for measuring fair value and expands financial statement disclosures about fair value measurements. Items to which the deferral under FSP No. SFAS 157-2 applied include nonrecurring fair value measurements of nonfinancial assets and nonfinancial liabilities, or recurring fair value measurements of nonfinancial assets and nonfinancial liabilities, which are not disclosed at fair value in the consolidated financial statements. We did not have nonfinancial assets or nonfinancial liabilities covered by the provisions of SFAS No. 157 which required remeasurement upon adoption or during the three months ended March 31, 2009, and therefore there was no impact of adoption on our financial position, results of operations, or cash flows.

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We adopted the provisions of SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements (SFAS No. 160), on January 1, 2009. SFAS No. 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent s ownership interest and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS No. 160 also establishes reporting requirements that provide enhanced disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. There was no impact of adoption of SFAS No. 160 on our financial position, results of operations or cash flows.

We adopted the provisions of SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of SFAS No. 133 (SFAS No. 161), on January 1, 2009. SFAS No. 161 changes the disclosure requirements for derivative instruments and hedging activities. This standard requires enhanced disclosures about how and why an entity uses derivative instruments, how instruments are accounted for under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS No. 133), and how derivatives and hedging activities affect an entity s financial position, financial performance and cash flows. The adoption of SFAS No. 161 required additional disclosure only, and therefore did not have an impact on our financial position, results of operations, or cash flows. See Note 16 for a discussion of our derivative instruments and hedging activities.

We adopted the provisions of FSP Financial Accounting Standard (FAS) 142-3, Determination of the Useful Life of Intangible Assets (FSP FAS 142-3), on January 1, 2009. FSP FAS 142-3 amends SFAS No. 142, Goodwill and Other Intangible Assets (SFAS No. 142) to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141(R) and other U.S. GAAP. As the provisions of FSP FAS 142-3 are applied prospectively, there was no impact of adoption on our financial position, results of operations, or cash flows.

NOTE 3. SHARE-BASED COMPENSATION

For the three months ended March 31, 2009, share-based compensation expense included $2.7 million for options, restricted stock units and deferred stock units with vesting conditions and $0.2 million for employee stock purchase rights. Expense for deferred stock units issued under our Director Deferred Compensation Plan without vesting conditions of $0.1 million for the three months ended March 31, 2009 and 2008 has been excluded from share-based compensation in the table below, as it relates to deferred stock units granted to directors in lieu of cash compensation. Share-based compensation expense has been included in our condensed consolidated statements of operations for the three months ended March 31, 2009 and 2008 as follows (*in thousands*):

	For the Three Months Ended March 31,	
	2009	**2008**
Cost of revenue	$ 218	$ 186
Sales and marketing	353	423
General and administrative	1,848	1,655
Research and development	443	547
Total	$ 2,862	$ 2,811

The fair value of options, restricted stock units, deferred stock units with vesting conditions, and employee stock purchase rights awarded during the three months ended March 31, 2009 and 2008 totaled $15.1 million and $17.9 million, respectively. The total unrecognized compensation cost for unvested share-based compensation awards outstanding at March 31, 2009, before consideration of estimated forfeitures, was $42.8 million. We estimate that this cost will be reduced by approximately $3.9 million related to forfeitures. The weighted average remaining expense recognition period at March 31, 2009 was approximately 2.3 years.

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Options

We determine the assumptions to be used in the valuation of option grants as of the date of grant. Differences in the terms of options granted to different segments of employees may necessitate distinct valuation assumptions for those segments. As such, we may use different assumptions during the fiscal year if we grant options at different dates or with varying terms. The weighted averages of the valuation assumptions used to determine the fair value of each option grant on the date of grant and the weighted average estimated fair values were as follows:

	For the Three Months Ended March 31,	
	2009	2008
Expected stock price volatility	30%	25%
Expected term, in years	4.8	4.9
Risk-free interest rate	1.6%	2.7%
Weighted average fair value of options granted	$ 9.97	$ 15.31

The total fair value of options that vested during the three months ended March 31, 2009 and 2008 was $9.5 million and $10.2 million, respectively.

Restricted and Other Deferred Stock Units with Vesting Conditions

The combined weighted average fair value per unit of restricted stock units and deferred stock units with vesting conditions granted during the three months ended March 31, 2009 and 2008 was $34.37 and $56.95, respectively.

NOTE 4. INVENTORIES

Inventories include material, labor and overhead, and are stated at the lower of cost (first-in, first-out) or market. The components of inventories were as follows *(in thousands)*:

	March 31, 2009	December 31, 2008
Raw materials	$ 37,912	$ 32,575
Work-in-process	17,789	18,428
Finished goods	67,874	64,923
	$ 123,575	$ 115,926

NOTE 5. PROPERTY AND EQUIPMENT

Net property and equipment consisted of the following (*in thousands*):

	March 31, 2009	December 31, 2008
Land and improvements	$ 7,127	$ 8,189
Buildings and improvements	89,936	90,042
Leasehold improvements	17,714	17,275
Machinery and equipment	105,110	106,632
Office furniture and equipment	76,447	74,885
Construction in progress	26,615	23,175
	322,949	320,198
Less accumulated depreciation and amortization	136,241	130,552

Total property and equipment, net	$ 186,708	$ 189,646

Depreciation expense was $9.9 million and $8.3 million for the three months ended March 31, 2009 and 2008, respectively.

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NOTE 6. GOODWILL AND OTHER INTANGIBLE ASSETS

Intangible assets other than goodwill consisted of the following *(in thousands)*:

	March 31, 2009		December 31, 2008	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Patents	$ 9,710	$ 4,524	$ 9,748	$ 4,306
Product rights (1)	31,127	13,425	32,187	13,180
Customer-related intangible assets (2)	51,599	12,627	52,642	11,844
Other, primarily noncompete agreements	6,131	3,401	6,268	3,188
	$ 98,567	$ 33,977	$ 100,845	$ 32,518

(1) Product rights comprise certain technologies, licenses, trade names and contractual rights acquired from third parties.

(2) Customer-related intangible assets comprise customer lists and customer relationships acquired from third parties.

Amortization expense of intangible assets was $2.4 million and $2.6 million for the three months ended March 31, 2009 and 2008, respectively.

Goodwill by segment consisted of the following *(in thousands)*:

	March 31, 2009	December 31, 2008
CAG segment	$ 107,723	$ 109,502
Water segment	12,596	12,757
Production animal segment	9,308	9,978
Other segment	6,531	6,531
	$ 136,158	$ 138,768

We did not enter into any acquisition-related transactions during the three months ended March 31, 2009. The changes in the cost of intangible assets other than goodwill and the changes in goodwill during the three months ended March 31, 2009 resulted from changes in foreign currency exchange rates.

NOTE 7. WARRANTY RESERVES

We provide for the estimated cost of instrument warranties in cost of product revenue at the time revenue is recognized based on the estimated cost to repair the instrument over its warranty period. Cost of revenue reflects not only estimated warranty expense for the systems sold in the current period, but also any changes in estimated warranty expense for the installed base that results from our quarterly evaluation of service experience. Our actual warranty obligation is affected by instrument performance in the customers environment and costs incurred in servicing instruments. Should actual service rates or costs differ from our estimates, which are based on historical data and projections of future costs, revisions to our estimated warranty liability would be required.

Following is a summary of changes in accrued warranty reserves during the three months ended March 31, 2009 and 2008 *(in thousands)*:

	For the Three Months Ended March 31,	
	2009	**2008**
Balance, beginning of period	$ 2,837	$ 1,667
Provision for warranty expense	1,264	507
Change in estimate, balance beginning of period	(69)	(66)
Settlement of warranty liability	(926)	(547)
Balance, end of period	$ 3,106	$ 1,561

NOTE 8. DEBT

At March 31, 2009 we had $165.5 million outstanding under our unsecured short-term revolving credit facility (Credit Facility) with a weighted average interest rate of 1.1%, which approximates the rate that we would pay on additional borrowings with similar maturities under the Credit Facility at March 31, 2009. Of the total amount outstanding at March 31, 2009, $6.5 million was borrowed by our Canadian subsidiary and denominated in Canadian dollars. The applicable interest rates on our Credit Facility generally range from 0.375 to 0.875 percentage points (Credit Spread) above the London interbank rate or the Canadian Dollar-denominated bankers acceptance rate, dependent on our leverage ratio.

In March 2009, we entered into two forward fixed interest rate swap agreements to manage the economic effect of variable interest obligations. See Note 16 for a discussion of our derivative instruments and hedging activities.

NOTE 9. INCOME TAXES

Our effective income tax rates were 31.5% and 27.9% for the three months ended March 31, 2009 and 2008, respectively. The increase in the effective tax rate for the three months ended March 31, 2009 as compared to the three months ended March 31, 2008 relates primarily to a reduction in international deferred tax liabilities in 2008 due to a change in the statutory tax rates for a jurisdiction in which we operate. This non-recurring benefit of approximately $1.5 million reduced our effective income tax rate for the three months ended March 31, 2008 by 3.9 percentage points. The impact of the non-recurring item was partly offset by federal research and development tax incentives that were available for the three months ended March 31, 2009 due to a change in the tax law, but not available for the three months ended March 31, 2008.

NOTE 10. COMPREHENSIVE INCOME

The following is a summary of comprehensive income for the three months ended March 31, 2009 and 2008 *(in thousands)*:

	For the Three Months Ended March 31, 2009	For the Three Months Ended March 31, 2008
Net income	$ 26,071	$ 27,551
Other comprehensive income (loss):		
Foreign currency translation adjustments	(7,093)	10,021
Change in fair value of foreign currency contracts classified as hedges, net of tax	(1,287)	(1,281)
Change in fair value of interest rate swaps classified as hedges, net of tax	(213)	