MERIT MEDICAL SYSTEMS INC
Form 10-Q
November 09, 2018
MERIT MEDICAL SYSTEMS INC0000856982Large Accelerated Filer2018Q3falseFALSEFALSE2018-09-30--12-312,0111,76993,68072,42046,08838,1275,0005,000——100,000100,00054,8
years2.19.9159.915——00008569822018-01-012018-09-30xbrli:shares00008569822018-11-05iso4217:USD0000856982201
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# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION
**Washington, D.C. 20549**

# FORM 10-Q

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

**FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2018**

**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 0-18592** |

## MERIT MEDICAL SYSTEMS, INC.
(Exact name of registrant as specified in its charter)

| **Utah** | **87-0447695** |
|---|---|
| (State or other jurisdiction of | (IRS Employer Identification |

| incorporation or organization) | No.) |
|---|---|

**1600 West Merit Parkway, South Jordan, Utah 84095**
(Address of principal executive offices, including zip code)
Registrant’s telephone number, including area code: **(801) 253-1600**

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 x No o

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes x No o

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

| Large Accelerated Filer x | Accelerated Filer o | Non-Accelerated Filer o | Smaller Reporting Company o | Emerging Growth Company o |
|---|---|---|---|---|

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. 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 x

Indicate the number of shares outstanding of each of the Registrant’s classes of common stock, as of the latest practicable date.

| **Common Stock** | 54,833,602 |
|---|---|
| Title or class | Number of Shares Outstanding at November 5, 2018 |

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## PART I - FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

**MERIT MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**

CONSOLIDATED BALANCE SHEETS

AS OF SEPTEMBER 30, 2018 AND DECEMBER 31, 2017

(In thousands)

| | September 30, 2018 (unaudited) | December 31, 2017 |
|---|---|---|
| **ASSETS** | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $ 51,955 | $ 32,336 |
| Trade receivables — net of allowance for uncollectible accounts — 2018 — $2,011 and 2017 — $1,769 | 129,282 | 105,536 |
| Other receivables | 8,903 | 9,429 |
| Inventories | 181,439 | 155,288 |
| Prepaid expenses and other assets | 11,720 | 9,096 |
| Prepaid income taxes | 3,307 | 3,225 |
| Income tax refund receivables | 1,043 | 1,211 |
| Total current assets | 387,649 | 316,121 |
| PROPERTY AND EQUIPMENT: | | |

| | | |
|---|---|---|
| Land and land improvements | 26,926 | 19,877 |
| Buildings | 150,880 | 147,356 |
| Manufacturing equipment | 211,215 | 197,651 |
| Furniture and fixtures | 53,869 | 49,528 |
| Leasehold improvements | 33,365 | 31,161 |
| Construction-in-progress | 48,166 | 32,896 |
| Total property and equipment | 524,421 | 478,469 |
| Less accumulated depreciation | (204,496) | (185,649) |
| Property and equipment — net | 319,925 | 292,820 |
| OTHER ASSETS: | | |
| Intangible assets: | | |
| Developed technology — net of accumulated amortization — 2018 — $93,680 and 2017 — $72,420 | 224,540 | 167,771 |
| Other — net of accumulated amortization — 2018 — $46,088 and 2017 — $38,127 | 64,565 | 59,553 |
| Goodwill | 249,023 | 238,147 |
| Deferred income tax assets | 2,254 | 2,359 |
| Other assets | 61,927 | 35,040 |

| | | | |
|---|---|---|---|
| Total other assets | 602,309 | | 502,870 |
| TOTAL | $ 1,309,883 | $ | 1,111,811 |

See condensed notes to consolidated financial statements.

(continued)

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**MERIT MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**

CONSOLIDATED BALANCE SHEETS

AS OF SEPTEMBER 30, 2018 AND DECEMBER 31, 2017

(In thousands)

| | September 30, 2018 (unaudited) | December 31, 2017 |
|---|---|---|
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| CURRENT LIABILITIES: | | |
| Trade payables | $ 50,697 | $ 34,931 |
| Accrued expenses | 65,530 | 58,932 |
| Current portion of long-term debt | 22,000 | 19,459 |
| Income taxes payable | 1,598 | 2,298 |
| Total current liabilities | 139,825 | 115,620 |
| LONG-TERM DEBT | 186,867 | 259,013 |
| DEFERRED INCOME TAX LIABILITIES | 23,102 | 23,289 |
| LONG-TERM INCOME TAXES PAYABLE | 4,846 | 4,846 |
| LIABILITIES RELATED TO UNRECOGNIZED TAX BENEFITS | 2,746 | 2,746 |
| DEFERRED COMPENSATION PAYABLE | 12,176 | 11,181 |
| DEFERRED CREDITS | 2,296 | 2,403 |
| | 14,814 | 16,379 |

| | | |
|---|---|---|
| OTHER LONG-TERM OBLIGATIONS | | |
| Total liabilities | 386,672 | 435,477 |
| COMMITMENTS AND CONTINGENCIES (Notes 5, 10, 11, and 14) | | |
| STOCKHOLDERS' EQUITY: | | |
| Preferred stock — 5,000 shares authorized as of September 30, 2018 and December 31, 2017; no shares issued | — | — |
| Common stock, no par value; shares authorized — 2018 and 2017 - 100,000; issued and outstanding as of September 30, 2018 - 54,802 and December 31, 2017 - | 568,051 | 353,392 |

| | | | | |
|---|---|---|---|---|
| 50,248 | | | | |
| Retained earnings | 354,236 | | 321,408 | |
| Accumulated other comprehensive income | 924 | | 1,534 | |
| Total stockholders' equity | 923,211 | | 676,334 | |
| TOTAL | $ | 1,309,883 | $ | 1,111,811 |

See condensed notes to consolidated financial statements. (concluded)

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**MERIT MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**

CONSOLIDATED STATEMENTS OF INCOME

FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2018 AND 2017

(In thousands, except per share amounts - unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2018** | **2017** | **2018** | **2017** |
| NET SALES | $ 221,659 | $ 179,337 | $ 649,504 | $ 536,955 |
| COST OF SALES | 119,620 | 98,823 | 359,400 | 296,358 |
| GROSS PROFIT | 102,039 | 80,514 | 290,104 | 240,597 |
| OPERATING EXPENSES: | | | | |
| Selling, general and administrative | 66,382 | 54,716 | 200,389 | 169,896 |
| Research and development | 14,525 | 12,838 | 44,163 | 38,676 |
| Intangible asset impairment charge | 657 | — | 657 | — |
| Contingent consideration expense (benefit) | (661) | 20 | (442) | 39 |
| Acquired in-process research and development | 75 | 12,061 | 382 | 12,136 |
| Total operating expenses | 80,978 | 79,635 | 245,149 | 220,747 |
| INCOME FROM OPERATIONS | 21,061 | 879 | 44,955 | 19,850 |
| OTHER INCOME (EXPENSE): | | | | |
| Interest income | 359 | 94 | 847 | 266 |
| Interest expense | (2,329) | (1,590) | (8,064) | (5,935) |
| Gain on bargain purchase | — | (778) | — | 10,796 |

| | | | | |
|---|---|---|---|---|
| Other income (expense) - net | 294 | (810) | (429) | (376) |
| Other income (expense) — net | (1,676) | (3,084) | (7,646) | 4,751 |
| INCOME (LOSS) BEFORE INCOME TAXES | 19,385 | (2,205) | 37,309 | 24,601 |
| INCOME TAX EXPENSE | 2,766 | 1,364 | 4,481 | 3,884 |
| NET INCOME (LOSS) | $ 16,619 | $ (3,569) | $ 32,828 | $ 20,717 |
| EARNINGS PER COMMON SHARE: | | | | |
| Basic | $ 0.31 | $ (0.07) | $ 0.64 | $ 0.43 |
| Diluted | $ 0.30 | $ (0.07) | $ 0.62 | $ 0.42 |
| AVERAGE COMMON SHARES: | | | | |
| Basic | 53,431 | 50,150 | 51,434 | 48,332 |
| Diluted | 55,103 | 51,599 | 53,096 | 49,555 |

See condensed notes to consolidated financial statements.

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**MERIT MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2018 AND 2017
(In thousands - unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2018** | **2017** | **2018** | **2017** |
| Net income | $ 16,619 | $ (3,569) | $ 32,828 | $ 20,717 |
| Other comprehensive income (loss): | | | | |
| Cash flow hedges | 667 | (144) | 3,541 | 166 |
| Less income tax benefit (expense) | (172) | 56 | (910) | (64) |
| Foreign currency translation adjustment | (1,637) | 721 | (3,241) | 2,925 |
| Less income tax (expense) | — | — | — | (252) |
| Total other comprehensive income (loss) | (1,142) | 633 | (610) | 2,775 |
| Total comprehensive income (loss) | $ 15,477 | $ (2,936) | $ 32,218 | $ 23,492 |

See condensed notes to consolidated financial statements.

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**MERIT MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2018 AND 2017

(In thousands - unaudited)

| | Nine Months Ended September 30, | | | |
|---|---|---|---|---|
| | **2018** | | **2017** | |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | | |
| Net income | $ | 32,828 | $ | 20,717 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | | |
| Depreciation and amortization | 50,436 | | 39,388 | |
| Gain on bargain purchase | — | | (10,796) | |
| Loss on sales and/or abandonment of property and equipment | 425 | | 219 | |
| Write-off of patents and intangible assets | 744 | | 86 | |
| Acquired in-process research and development | 382 | | 12,136 | |
| | (106) | | (111) | |

| | | |
|---|---|---|
| Amortization of deferred credits | | |
| Amortization of long-term debt issuance costs | 603 | 514 |
| Deferred income taxes | — | (290) |
| Stock-based compensation expense | 4,494 | 2,883 |
| Changes in operating assets and liabilities, net of effects from acquisitions: | | |
| Trade receivables | (25,482) | (10,963) |
| Other receivables | 255 | (449) |
| Inventories | (10,375) | (9,922) |
| Prepaid expenses and other current assets | (2,719) | (1,587) |
| Prepaid income taxes | (120) | (231) |
| Income tax refund receivables | 134 | 280 |
| Other assets | (1,370) | (2,992) |
| Trade payables | 15,936 | (876) |
| Accrued expenses | 7,707 | 4,470 |
| Income taxes payable | (1,528) | (764) |
| Deferred compensation payable | 994 | 1,107 |

| | | |
|---|---|---|
| Other long-term obligations | (1,381) | 574 |
| Total adjustments | 30,029 | 22,676 |
| Net cash provided by operating activities | 62,857 | 43,393 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Capital expenditures for: | | |
| Property and equipment | (47,024) | (29,522) |
| Intangible assets | (2,234) | (1,927) |
| Proceeds from the sale of property and equipment | 7 | 9 |
| Issuance of note receivable | (10,750) | — |
| Cash paid in acquisitions, net of cash acquired | (122,770) | (103,500) |
| Net cash used in investing activities | (182,771) | (134,940) |

See condensed notes to consolidated financial statements. (continued)

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**MERIT MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2018 AND 2017

(In thousands - unaudited)

| | Nine Months Ended September 30, | |
|---|---|---|
| | **2018** | **2017** |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from issuance of common stock | $ 213,276 | $ 143,069 |
| Offering costs | (366) | (816) |
| Proceeds from issuance of long-term debt | 380,825 | 151,462 |
| Payments on long-term debt | (450,575) | (197,962) |
| Contingent payments related to acquisitions | (184) | (45) |
| Payment of taxes related to an exchange of common stock | (2,616) | — |
| Net cash provided by financing activities | 140,360 | 95,708 |
| EFFECT OF EXCHANGE | (827) | 30 |

| | | | | |
|---|---|---|---|---|
| RATES ON CASH | | | | |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | 19,619 | | 4,191 | |
| CASH AND CASH EQUIVALENTS: | | | | |
| Beginning of period | 32,336 | | 19,171 | |
| End of period | $ | 51,955 | $ | 23,362 |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION | | | | |
| Cash paid during the period for: | | | | |
| Interest (net of capitalized interest of $468 and $371, respectively) | $ | 8,018 | $ | 5,953 |
| Income taxes | $ | 6,069 | $ | 4,029 |
| SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING AND FINANCING ACTIVITIES | | | | |
| Property and equipment purchases in | $ | 3,058 | $ | 1,394 |

| | | | | |
|---|---|---|---|---|
| accounts payable | | | | |
| Acquisition purchases in accrued expenses and other long-term obligations | $ | — | $ | 12,000 |
| Merit common stock surrendered (43 and 0 shares, respectively) in exchange for exercise of stock options | $ | 2,262 | $ | — |

See condensed notes to consolidated financial statements. (concluded)

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**MERIT MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

**1. Basis of Presentation.** The interim consolidated financial statements of Merit Medical Systems, Inc. ("Merit," "we" or "us") for the three and nine-month periods ended September 30, 2018 and 2017 are not audited. Our consolidated financial statements are prepared in accordance with the requirements for unaudited interim periods and, consequently, do not include all disclosures required to be made in conformity with accounting principles generally accepted in the United States of America. In the opinion of our management, the accompanying consolidated financial statements contain all adjustments, consisting of normal recurring accruals, necessary for a fair presentation of our financial position as of September 30, 2018 and December 31, 2017, and our results of operations and cash flows for the three and nine-month periods ended September 30, 2018 and 2017. The results of operations for the three and nine-month periods ended September 30, 2018 and 2017 are not necessarily indicative of the results for a full-year period. These interim consolidated financial statements should be read in conjunction with the financial statements included in our Annual Report on Form 10-K (the "2017 Form 10-K") for the year ended December 31, 2017, which was filed with the Securities and Exchange Commission (the "SEC") on March 1, 2018.

**2. Inventories.** Inventories at September 30, 2018 and December 31, 2017, consisted of the following (in thousands):

| | September 30, 2018 | | December 31, 2017 | |
|---|---|---|---|---|
| Finished goods | $ | 103,258 | $ | 86,555 |
| Work-in-process | 20,546 | | 12,799 | |
| Raw materials | 57,635 | | 55,934 | |
| Total Inventories | $ | 181,439 | $ | 155,288 |

**3. Stock-Based Compensation Expense**. Stock-based compensation expense before income tax expense for the three and nine months ended September 30, 2018 and 2017, consisted of the following (in thousands):

| | Three Months Ended September 30, | | | | | | Nine Months Ended September 30, | |
|---|---|---|---|---|---|---|---|---|
| | 2018 | | 2017 | | 2018 | | 2017 | |
| Cost of sales | $ | 241 | $ | 189 | $ | 657 | $ | 453 |
| Research and development | 141 | | 110 | | 412 | | 262 | |
| Selling, general and administrative | 1,291 | | 893 | | 3,425 | | 2,168 | |
| Stock-based compensation expense before taxes | $ | 1,673 | $ | 1,192 | $ | 4,494 | $ | 2,883 |

We recognize stock-based compensation expense (net of a forfeiture rate) for those awards which are expected to vest on a straight-line basis over the requisite service period. We estimate the forfeiture rate based on our historical experience and expectations about future forfeitures. As of September 30, 2018, the total remaining unrecognized compensation cost related to non-vested stock options, net of expected forfeitures, was approximately $20.7 million and is expected to be recognized over a weighted average period of 3.25 years.

During the three-month period ended September 30, 2018, we did not grant any new stock-based awards. During the nine-month period ended September 30, 2018, we granted stock-based awards representing 692,002 shares of our common stock. During the three and nine-month periods ended September 30, 2017, we granted stock-based awards representing 20,000 and approximately 1.3 million shares of our common stock, respectively. We use the Black-Scholes methodology to value the stock-based compensation expense for options. In applying the Black-Scholes methodology to the option grants, the fair value of our stock-based awards granted was estimated using the following assumptions for the periods indicated below:

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| | Nine Months Ended September 30, | |
|---|---|---|
| | **2018** | **2017** |
| Risk-free interest rate | 2.63% - 2.77% | 1.77% - 1.83% |
| Expected option life | 5.0 years | 5.0 years |
| Expected dividend yield | — | — |
| Expected price volatility | 34.06% - 34.32% | 33.81% - 34.07% |

The average risk-free interest rate is determined using the U.S. Treasury rate in effect as of the date of grant, based on the expected term of the stock options. We determine the expected term of the stock options using the historical exercise behavior of employees. The expected price volatility was determined using a weighted average of daily historical volatility of our stock price over the corresponding expected option life and implied volatility based on recent trends of the daily historical volatility. For options with a vesting period, compensation expense is recognized on a straight-line basis over the service period, which corresponds to the vesting period.

**4. Earnings Per Common Share (EPS).** The computation of weighted average shares outstanding and the basic and diluted earnings per common share for the following periods consisted of the following (in thousands, except per share amounts):

| | Three Months | | | Nine Months | | |
|---|---|---|---|---|---|---|
| | **Net Income** | **Shares** | **Per Share Amount** | **Net Income** | **Shares** | **Per Share Amount** |
| Period ended September 30, 2018: | | | | | | |
| Basic EPS | $ 16,619 | 53,431 | $ 0.31 | $ 32,828 | 51,434 | $ 0.64 |
| Effect of dilutive stock options and warrants | | 1,672 | | | 1,662 | |
| Diluted EPS | $ 16,619 | 55,103 | $ 0.30 | $ 32,828 | 53,096 | $ 0.62 |
| Stock options excluded from the calculation of common stock equivalents as the impact was anti-dilutive | | 667 | | | 462 | |
| Period ended September 30, 2017: | | | | | | |
| Basic EPS | $ (3,569) | 50,150 | $ (0.07) | $ 20,717 | 48,332 | $ 0.43 |
| | | 1,449 | | | 1,223 | |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Effect of dilutive stock options and warrants | | | | | | | | | |
| Diluted EPS | $ | (3,569) | 51,599 | $ | (0.07) | $ | 20,717 | 49,555 | $ 0.42 |
| Stock options excluded from the calculation of common stock equivalents as the impact was anti-dilutive | | | 200 | | | | | 434 | |

**5. Acquisitions.** During July 2018, we purchased 1,786,000 preferred limited liability company units of Cagent Vascular, LLC, a medical device company ("Cagent"), for approximately $2.2 million. Our investment has been accounted for as an equity investment reflected within other assets in the accompanying consolidated balance sheets because we are not able to exercise significant influence over the operations of Cagent. Our total investment in Cagent represents an ownership of approximately 19.5% of the outstanding limited liability company units.

On May 23, 2018, we entered into an asset purchase agreement with DirectACCESS Medical, LLC (“DirectACCESS”) to acquire its assets, including, certain product distribution agreements for the FirstChoice™ Ultra High Pressure PTA Balloon Catheter. We accounted for this acquisition as a business combination. The purchase price for the assets was approximately $7.3 million. The sales and results of operations related to the acquisition have been included in our cardiovascular segment since the acquisition date and were not material. Acquisition-related costs associated with the DirectACCESS acquisition, which were included in selling, general and administrative expenses in our consolidated statements of income, were not material. The purchase price was preliminarily allocated as follows (in thousands):

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| | | |
|---|---|---|
| Inventories | $ | 971 |
| Intangibles | | |
| Developed technology | 4,840 | |
| Customer list | 120 | |
| Trademarks | 400 | |
| Goodwill | 938 | |
| **Total assets acquired** | **$** | **7,269** |

We are amortizing the developed technology intangible asset over ten years, the related trademarks over ten years and the customer list on an accelerated basis over five years. The total weighted-average amortization period for these acquired intangible assets is approximately 9.9 years.

On May 18, 2018, we paid $750,000 for a distribution agreement with QXMédical, LLC ("QXMédical") for the Q50® PLUS Stent Graft Balloon Catheter. We accounted for this acquisition as an asset purchase. We are amortizing the distribution agreement as an intangible asset over a period of ten years.

On April 6, 2018, we entered into long-term agreements with NinePoint Medical, Inc. (“NinePoint”), pursuant to which, we (a) became the exclusive worldwide distributor for the NvisionVLE® Imaging System with Real-time Targeting™ using Optical Coherence Tomography (OCT) and (b) acquired an option to purchase up to 100% of the outstanding equity in NinePoint throughout a three-month period commencing 18 months subsequent to the agreement date, both in exchange for total consideration of $10.0 million. We accounted for this transaction as an asset purchase. The results of operations related to the distribution agreement have been included in our endoscopy operating segment since the acquisition date. During the three and nine months ended September 30, 2018, our net sales of NinePoint products were approximately $1.4 million and $2.5 million, respectively. We believe the NinePoint products will enhance the product offerings of our endoscopy operating segment and will be another step in our strategy to add therapy and disease-state products to our portfolio. The NinePoint products have 510(k) clearance in the United States, and NinePoint is preparing a CE mark application. We plan to launch the NinePoint products globally on a measured basis.

In addition, on April 6, 2018, we made a loan to NinePoint for $10.5 million with a maturity date of April 6, 2023, at which time the loan, together with accrued interest thereon, will be due and payable. The loan bears interest at an annual rate of 9% and is collateralized by NinePoint's rights, interest and title to the NvisionVLE® Imaging System and substantially all other assets of NinePoint. This loan has been recorded as a note receivable within other long-term assets in our consolidated balance sheets.

On February 14, 2018, we acquired certain divested assets from Becton, Dickinson and Company ("BD"), for an aggregate purchase price of $100.3 million. The assets acquired include the soft tissue core needle biopsy products sold under the tradenames of Achieve® Programmable Automatic Biopsy System, Temno® Biopsy System, Tru-Cut® Biopsy Needles as well as Aspira® Pleural Effusion Drainage Kits, and the Aspira® Peritoneal Drainage System. We accounted for this acquisition as a business combination.

During the three and nine-month periods ended September 30, 2018, our net sales of BD products were approximately $11.8 million and $30.3 million, respectively. It is not practical to separately report earnings related to the products acquired from BD, as we cannot split out sales costs related solely to the products we acquired from BD, principally because our sales representatives sell multiple products (including the products we acquired from BD) in our cardiovascular business segment. Acquisition-related costs associated with the BD acquisition, which are included in selling, general and administrative expenses in the accompanying consolidated statements of income, were

approximately $1.8 million for the nine-month period ended September 30, 2018. The following table summarizes the purchase price allocated to the assets acquired from BD (in thousands):

| | | |
|---|---|---|
| Inventories | $ | 5,804 |
| Property and equipment | 748 | |
| Intangibles | | |
| Developed technology | 74,000 | |
| Customer list | 4,200 | |
| Trademarks | 4,900 | |
| Goodwill | 10,613 | |
| **Total assets acquired** | **$** | **100,265** |

We are amortizing the developed technology intangible assets over eight years, the related trademarks over nine years, and the customer lists on an accelerated basis over seven years. The total weighted-average amortization period for these acquired intangible assets is approximately eight years.

On October 2, 2017, we acquired a custom procedure pack business located in Melbourne, Australia from ITL Healthcare Pty Ltd. ("ITL"), for an aggregate purchase price of $11.3 million. We accounted for this acquisition as a business combination. The following table summarizes the aggregate purchase price allocated to the assets acquired from ITL (in thousands):

| | | |
|---|---|---|
| **Assets Acquired** | | |
| Trade receivables | $ | 1,287 |
| Other receivables | 56 | |
| Inventories | 1,808 | |
| Prepaid expenses and other assets | 65 | |
| Property and equipment | 1,053 | |
| Intangibles | | |
| Customer lists | 5,940 | |
| Goodwill | 3,945 | |
| Total assets acquired | 14,154 | |
| **Liabilities Assumed** | | |
| Trade payables | (216) | |
| Accrued expenses | (747) | |
| Deferred income tax liabilities | (1,901) | |
| Total liabilities assumed | (2,864) | |

| | | |
|---|---|---|
| **Total net assets acquired** | **$** | **11,290** |

We are amortizing the customer list on an accelerated basis over seven years. Acquisition-related costs associated with the ITL acquisition, which were included in selling, general and administrative expenses in the consolidated statements of income in the 2017 Form 10-K, were not material. The results of operations related to this acquisition have been included in our cardiovascular operating segment since the acquisition date. During the three and nine months ended September 30, 2018, our net sales of ITL products were approximately $1.9 million and $6.1 million, respectively. It is not practical to separately report the earnings related to the ITL acquisition, as we cannot split out sales costs related solely to the products we acquired from ITL, principally because our sales representatives sell multiple products (including the products we acquired from ITL) in our cardiovascular business segment.

On August 4, 2017, we acquired from Laurane Medical S.A.S. ("Laurane") and its shareholders inventories and the intellectual property rights associated with certain manual bone biopsy devices, manual bone marrow needles and muscle biopsy kits for an aggregate purchase price of $16.5 million. We also recorded a contingent consideration liability of $5.5 million related to royalties potentially payable to Laurane's shareholders pursuant to the terms of an intellectual property purchase agreement. We accounted for this acquisition as a business combination. The following table summarizes the aggregate purchase price (including contingent royalty payment liabilities) allocated to the assets acquired from Laurane (in thousands):

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| | | |
|---|---|---|
| Inventories | $ | 594 |
| Intangibles | | |
| Developed technology | 14,920 | |
| Customer list | 120 | |
| Goodwill | 6,366 | |
| **Total assets acquired** | **$** | **22,000** |

We are amortizing the developed technology intangible asset over 12 years and the customer list on an accelerated basis over one year. The total weighted-average amortization period for these acquired intangible assets is 11.9 years. The sales and results of operations related to the acquisition have been included in our cardiovascular segment since the acquisition date and were not material. Acquisition-related costs associated with the Laurane acquisition, which were included in selling, general and administrative expenses in the consolidated statements of income of our 2017 Form 10-K, were not material.

On July 3, 2017, we acquired from Osseon LLC ("Osseon") substantially all the assets related to Osseon's vertebral augmentation products. We accounted for this acquisition as a business combination. The purchase price for the assets was approximately $6.8 million. Acquisition-related costs associated with the Osseon acquisition, which were included in selling, general and administrative expenses in the consolidated statements of income of our 2017 Form 10-K, were not material. The results of operations related to this acquisition have been included in our cardiovascular segment since the acquisition date. During the three and nine months ended September 30, 2018, our net sales of Osseon products were approximately $478,000 and $1.6 million, respectively. It is not practical to separately report the earnings related to the Osseon acquisition, as we cannot split out sales costs related solely to the products we acquired from Osseon, principally because our sales representatives sell multiple products (including the products we acquired from Osseon) in our cardiovascular business segment. The following table summarizes the purchase price allocated to the assets acquired (in thousands):

| | | |
|---|---|---|
| Inventories | $ | 979 |
| Property and equipment | 58 | |
| Intangibles | | |
| Developed technology | 5,400 | |
| Customer list | 200 | |
| Goodwill | 203 | |
| **Total assets acquired** | **$** | **6,840** |

We are amortizing the developed technology intangible asset over nine years and customer lists on an accelerated basis over eight years. The total weighted-average amortization period for these acquired intangible assets is approximately 9.0 years.

On May 1, 2017, we entered into an agreement and plan of merger with Vascular Access Technologies, Inc. ("VAT"), pursuant to which we acquired the SAFECVAD™ device. We accounted for this acquisition as a business combination. The purchase price for the acquisition was $5.0 million. We also recorded $4.9 million of contingent consideration related to royalties potentially payable to VAT pursuant to the merger agreement. The following table summarizes the purchase price allocated to the net assets acquired (in thousands):

| |
|---|
| Intangibles |

| | | |
|---|---|---|
| Developed technology | $ | 7,800 |
| In-process technology | 920 | |
| Goodwill | 4,281 | |
| Deferred tax liabilities | (3,101) | |
| **Total net assets acquired** | **$** | **9,900** |

We are amortizing the developed technology intangible asset over 15 years. The sales and results of operations related to the acquisition have been included in our cardiovascular segment since the acquisition date and were not material. Acquisition-related costs associated with the VAT acquisition, which were included in selling, general and administrative expenses in the consolidated statements of income of our 2017 Form 10-K, were not material.

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On January 31, 2017, we acquired the critical care division of Argon Medical Devices, Inc. ("Argon"), including a manufacturing facility in Singapore, the related commercial operations in Europe and Japan, and certain inventories and intellectual property rights within the United States. We made an initial payment of approximately $10.9 million and received a subsequent reduction to the purchase price of approximately $797,000 related to a working capital adjustment according to the terms of the purchase agreement. We accounted for the acquisition as a business combination.

Acquisition-related costs associated with the acquisition of the Argon critical care division during the year ended December 31, 2017, which were included in selling, general and administrative expenses in the consolidated statements of income of our 2017 Form 10-K, were approximately $2.6 million. The results of operations related to this acquisition have been included in our cardiovascular segment since the acquisition date. During the three and nine months ended September 30, 2018, our net sales of the Argon critical care products were approximately $11.0 million and $34.2 million, respectively. It is not practical to separately report the earnings related to the Argon critical care acquisition, as we cannot split out sales costs related solely to the products we acquired from Argon, principally because our sales representatives sell multiple products (including the products we acquired from Argon) in our cardiovascular business segment.

The assets and liabilities in the purchase price allocation for the Argon critical care acquisition are stated at fair value based on estimates of fair value using available information and making assumptions our management believes are reasonable. The following table summarizes the purchase price allocated to the net tangible and intangible assets acquired and liabilities assumed (in thousands):

| **Assets Acquired** | | |
|---|---|---|
| Cash and cash equivalents | $ | 1,436 |
| Trade receivables | 8,351 | |
| Inventories | 11,222 | |
| Prepaid expenses and other assets | 1,275 | |
| Income tax refund receivables | 165 | |
| Property and equipment | 2,319 | |
| Deferred income tax assets | 202 | |
| Intangibles | | |
| Developed technology | 2,200 | |
| Customer lists | 1,500 | |
| Trademarks | 900 | |

| | |
|---|---|
| Total assets acquired | 29,570 |
| **Liabilities Assumed** | |
| Trade payables | (2,414) |
| Accrued expenses | (5,083) |
| Deferred income tax liabilities | (934) |
| Total liabilities assumed | (8,431) |
| **Total net assets acquired** | **21,139** |
| Gain on bargain purchase (1) | (11,039) |
| **Total purchase price** | **$ 10,100** |

(1) The total fair value of the net assets acquired from Argon exceeded the purchase price, resulting in a gain on bargain purchase which was recorded within other income (expense) in our consolidated statements of income. We believe the reason for the gain on bargain purchase was a result of the divestiture of a non-strategic, slow-growth critical care business for Argon. It is our understanding that the divestiture allows Argon to focus on its higher growth interventional portfolio. A reduction of $1.2 million was recorded since the bargain purchase gain was first presented in our Quarterly Report on Form 10-Q for the quarter ended March 31, 2017, resulting from our ongoing activities, including reassessment of the assets acquired and liabilities assumed. The purchase price allocation for this acquisition is now final.

With respect to the Argon critical care assets, we are amortizing developed technology over seven years and customer lists on an accelerated basis over five years. While U.S. trademarks can be renewed indefinitely, we estimate that we will generate cash flow from the acquired trademarks for a period of five years from the acquisition date. The total weighted-average amortization period for these acquired intangible assets is approximately 6.0 years.

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On January 31, 2017, we acquired substantially all the assets, including intellectual property covered by approximately 40 patents and pending applications, and assumed certain liabilities, of Catheter Connections, Inc. ("Catheter Connections"), in exchange for payment of $38.0 million. Catheter Connections, based in Salt Lake City, Utah, developed and marketed the DualCap® System, an innovative family of disinfecting products designed to protect patients from intravenous infections resulting from infusion therapy. We accounted for this acquisition as a business combination.

Acquisition-related costs associated with the Catheter Connections acquisition during the year ended December 31, 2017, which were included in selling, general and administrative expenses were approximately $482,000. The results of operations related to this acquisition have been included in our cardiovascular operating segment since the acquisition date. During the three and nine months ended September 30, 2018, our net sales of the products acquired from Catheter Connections were approximately $3.7 million and $10.1 million, respectively. It is not practical to separately report the earnings related to the products acquired from Catheter Connections, as we cannot split out sales costs related solely to those products, principally because our sales representatives sell multiple products (including the DualCap System) in the cardiovascular business segment. The purchase price was allocated as follows (in thousands):

| | | |
|---|---|---|
| **Assets Acquired** | | |
| Trade receivables | $ | 958 |
| Inventories | 2,157 | |
| Prepaid expenses and other assets | 85 | |
| Property and equipment | 1,472 | |
| Intangibles | | |
| Developed technology | 21,100 | |
| Customer lists | 700 | |
| Trademarks | 2,900 | |
| Goodwill | 8,989 | |
| Total assets acquired | 38,361 | |
| **Liabilities Assumed** | | |
| Trade payables | (338) | |
| Accrued expenses | (23) | |
| Total liabilities assumed | (361) | |
| **Total net assets acquired** | **$** | **38,000** |

We are amortizing the Catheter Connections developed technology asset over 12 years, the related trademarks over ten years, and the associated customer list on an accelerated basis over eight years. We have estimated the weighted average life of the intangible Catheter Connections assets acquired to be approximately 11.7 years.

The following table summarizes our consolidated results of operations for the nine-month period ended September 30, 2017, as well as unaudited pro forma consolidated results of operations as though the acquisition of the Argon critical care division had occurred on January 1, 2016 (in thousands, except per common share amounts):

| | **Nine Months Ended September 30, 2017** | | | |
|---|---|---|---|---|
| | **As Reported** | | **Pro Forma** | |
| Net sales | $ | 536,955 | $ | 539,715 |
| Net income | 20,717 | | 10,039 | |
| Earnings per common share: | | | | |
| Basic | $ | 0.43 | $ | 0.21 |
| Diluted | $ | 0.42 | $ | 0.20 |

* The pro forma results for the three-month periods ended September 30, 2018 and 2017 and the nine-month period ended September 30, 2018 are not included in the table above because the operating results for the Argon critical care division acquisition were included in our consolidated statements of income for these periods.

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The unaudited pro forma information set forth above is for informational purposes only and includes adjustments related to the step-up of acquired inventories, amortization expense of acquired intangible assets, interest expense on long-term debt and changes in the timing of the recognition of the gain on bargain purchase. The pro forma information should not be considered indicative of actual results that would have been achieved if the acquisition of the Argon critical care division had occurred on January 1, 2016, or results that may be obtained in any future period. The pro forma consolidated results of operations do not include the acquisition of assets from BD because it was deemed impracticable to obtain information to determine net income associated with the acquired product lines which represent a small product line of a large, consolidated company without standalone financial information. The pro forma consolidated results of operations do not include the DirectACCESS, ITL, Laurane, Osseon, VAT or Catheter Connections acquisitions as we do not deem the pro forma effect of these transactions to be material.

The goodwill arising from the acquisitions discussed above consists largely of the synergies and economies of scale we hope to achieve from combining the acquired assets and operations with our historical operations. The goodwill recognized from certain acquisitions is expected to be deductible for income tax purposes.

**6. Revenue from Contracts with Customers.**

We sell our medical products through a direct sales force in the U.S. and through OEM relationships, custom procedure tray manufacturers and a combination of direct sales force and independent distributors in international markets. Revenue is recognized when a customer obtains control of promised goods based on the consideration we expect to receive in exchange for these goods. This core principle is achieved through the following steps:

*Identify the contract with the customer*. A contract with a customer exists when (i) we enter into an enforceable contract with a customer that defines each party’s rights regarding the goods to be transferred and identifies the payment terms related to these goods, (ii) the contract has commercial substance and, (iii) we determine that collection of substantially all consideration for services that are transferred is probable based on the customer’s intent and ability to pay the promised consideration. We do not have significant costs to obtain contracts with customers. For commissions on product sales, we have elected the practical expedient to expense the costs as incurred if the amortization period would have been one year or less.

*Identify the performance obligations in the contract*. Generally, our contracts with customers do not include multiple performance obligations to be completed over a period of time. Our performance obligations generally relate to delivering single-use medical products to a customer, subject to the shipping terms of the contract. Limited warranties are provided, under which we typically accept returns and provide either replacement parts or refunds. We do not have significant returns. We do not typically offer extended warranty or service plans.

*Determine the transaction price*. Payment by the customer is due under customary fixed payment terms, and we evaluate if collectability is reasonably assured. None of our contracts as of September 30, 2018 contained a significant financing component. Revenue is recorded at the net sales price, which includes estimates of variable consideration such as product returns, rebates, discounts, and other adjustments. The estimates of variable consideration are based on historical payment experience, historical and projected sales data, and current contract terms. Variable consideration is included in revenue only to the extent that it is probable that a significant reversal of the revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved. Taxes collected from customers relating to product sales and remitted to governmental authorities are excluded from revenues.

*Allocate the transaction price to performance obligations in the contract*. We typically do not have multiple performance obligations in our contracts with customers. As such, we recognize revenue upon transfer of the product to the customer's control at contractually stated pricing.

*Recognize revenue when or as we satisfy a performance obligation.* We satisfy performance obligations at a point in time upon either shipment or delivery of goods, in accordance with the terms of each contract with the customer. We do not have significant service revenue.

*Disaggregation of Revenue*

The disaggregation of revenue is based on type of product and geographical region. For descriptions of our product offerings and segments, see Note 12 in our 2017 Form 10-K.



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The following tables present revenue from contracts with customers for the three and nine-month periods ended September 30, 2018 and 2017 (in thousands):

| | Three Months Ended September 30, 2018 | | | | | Three Months Ended September 30, 2017 |
|---|---|---|---|---|---|---|
| | United States | International | Total | United States | International | Total |
| **Cardiovascular** | | | | | | |
| Stand-alone devices | $ 52,173 | $ 38,802 | $ 90,975 | $ 36,383 | $ 32,366 | $ 68,749 |
| Custom kits and procedure trays | 23,199 | 9,896 | 33,095 | 23,085 | 7,326 | 30,411 |
| Inflation devices | 7,819 | 15,074 | 22,893 | 8,241 | 11,792 | 20,033 |
| Catheters | 18,081 | 22,510 | 40,591 | 15,377 | 16,374 | 31,751 |
| Embolization devices | 5,145 | 7,250 | 12,395 | 5,414 | 6,838 | 12,252 |
| CRM/EP | 10,462 | 1,739 | 12,201 | 8,202 | 1,325 | 9,527 |
| Total | 116,879 | 95,271 | 212,150 | 96,702 | 76,021 | 172,723 |
| **Endoscopy** | | | | | | |
| Endoscopy devices | 9,229 | 280 | 9,509 | 6,389 | 225 | 6,614 |
| Total | $ 126,108 | $ 95,551 | $ 221,659 | $ 103,091 | $ 76,246 | $ 179,337 |

| | Nine Months Ended September 30, 2018 | | | | | Nine Months Ended September 30, 2017 |
|---|---|---|---|---|---|---|
| | United States | International | Total | United States | International | Total |
| **Cardiovascular** | | | | | | |
| Stand-alone devices | $ 147,125 | $ 119,592 | $ 266,717 | $ 109,750 | $ 93,709 | $ 203,459 |
| Custom kits and procedure trays | 69,184 | 31,175 | 100,359 | 68,823 | 22,259 | 91,082 |
| Inflation devices | 23,647 | 45,970 | 69,617 | 24,257 | 35,072 | 59,329 |
| Catheters | 50,055 | 63,775 | 113,830 | 46,529 | 47,828 | 94,357 |
| Embolization devices | 15,272 | 22,434 | 37,706 | 16,548 | 20,388 | 36,936 |
| CRM/EP | 31,058 | 5,105 | 36,163 | 28,212 | 3,765 | 31,977 |
| Total | 336,341 | 288,051 | 624,392 | 294,119 | 223,021 | 517,140 |
| **Endoscopy** | | | | | | |
| Endoscopy devices | 24,269 | 843 | 25,112 | 19,195 | 620 | 19,815 |
| Total | $ 360,610 | $ 288,894 | $ 649,504 | $ 313,314 | $ 223,641 | $ 536,955 |

**7. Segment Reporting.** We report our operations in two operating segments: cardiovascular and endoscopy. Our cardiovascular segment consists of cardiology and radiology medical device products which assist in diagnosing and

treating coronary artery disease, peripheral vascular disease and other non-vascular diseases and includes embolotherapeutic, cardiac rhythm management ("CRM"), electrophysiology ("EP"), critical care, and interventional oncology and spine devices. Our endoscopy segment focuses on the gastroenterology, pulmonary and thoracic surgery specialties, with a portfolio consisting primarily of stents, dilation balloons, certain inflation devices, guidewires, and other disposable products. We evaluate the performance of our operating segments based on operating income.

Financial information relating to our reportable operating segments and reconciliations to the consolidated totals for the three and nine-month periods ended September 30, 2018 and 2017, are as follows (in thousands):



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| | Three Months Ended September 30, | | | | Nine Months Ended September 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2018 | | 2017 | | 2018 | | 2017 | |
| **Net Sales** | | | | | | | | |
| Cardiovascular | $ | 212,150 | $ | 172,723 | $ | 624,392 | $ | 517,140 |
| Endoscopy | 9,509 | | 6,614 | | 25,112 | | 19,815 | |
| Total net sales | $ | 221,659 | $ | 179,337 | $ | 649,504 | $ | 536,955 |
| **Operating Income (Loss)** | | | | | | | | |
| Cardiovascular | $ | 18,199 | $ | (1,207) | $ | 37,263 | $ | 14,239 |
| Endoscopy | 2,862 | | 2,086 | | 7,692 | | 5,611 | |
| Total operating income | $ | 21,061 | $ | 879 | $ | 44,955 | $ | 19,850 |

## 8. Recently Issued Financial Accounting Standards

***Recently Adopted***

In October 2016, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") No. 2016-16, *Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other than Inventory*, which requires the recognition of the income tax consequences of an intra-entity transfer of an asset, other than inventory, when the transfer occurs. ASU 2016-16 became effective for us as of January 1, 2018. The adoption of ASU 2016-16 did not have a material impact on our consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*, which addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. We adopted ASU 2016-15 on January 1, 2018. The adoption of ASU 2016-15 did not have a material impact on our consolidated financial statements.

In January 2016, the FASB issued ASU No. 2016-01, *Financial Instruments - Overall: Recognition and Measurement of Financial Assets and Financial Liabilities*, which amends the guidance regarding the classification and measurement of financial instruments. Changes to the current guidance primarily affect the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. In addition, ASU 2016-01 clarifies guidance related to the valuation allowance assessment when recognizing deferred tax assets resulting from unrealized losses on available-for-sale debt securities. We adopted ASU 2016-01 on January 1, 2018. The adoption of ASU 2016-01 did not have a material impact on our consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which provides a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. We adopted this ASU (and all subsequent ASUs that modified Topic 606) effective January 1, 2018 on a modified retrospective basis. Adoption of this standard did not result in significant changes to our accounting policies, business processes, systems or controls, or have a material impact on our financial position, results of operations or cash flows. As such, prior period amounts are not adjusted and continue to be reported under accounting standards then in effect, and we did not record a cumulative adjustment to the opening equity balance of retained earnings as of January 1, 2018. However, additional disclosures have been added in accordance with the requirements of Topic 606 and are reflected in Note 6.

***Not Yet Adopted***

In August 2018, the FASB issued ASU 2018-15, *Intangibles-Goodwill and Other-Internal-Use Software (Subtopic 350-40)*. The new guidance reduces complexity for the accounting for costs of implementing a cloud computing service arrangement and aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal use software license). ASU 2018-15 is effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years, with early adoption permitted. Implementation may be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption. We are currently evaluating the anticipated impact of adopting ASU 2018-15 on our consolidated financial statements.

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In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820)—Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement*, which modifies disclosure requirements related to fair value measurements. The amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Implementation on a prospective or retrospective basis varies by specific disclosure requirement. The standard allows for early adoption of any removed or modified disclosures upon issuance of this ASU while delaying adoption of the additional disclosures until their effective date. We are currently evaluating the anticipated impact of adopting ASU 2018-13 on our consolidated financial statements.

In June 2018, the FASB issued ASU 2018-07, *Compensation-Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*, which simplifies the accounting for nonemployee share-based payment transactions by expanding the scope of ASC Topic 718, *Compensation - Stock Compensation*, to include share-based payment transactions for acquiring goods and services from nonemployees. Under the new standard, most of the guidance on stock compensation payments to nonemployees would be aligned with the requirements for share-based payments granted to employees. This standard is effective for annual reporting periods beginning after December 15, 2018, and interim periods within those fiscal years, with early adoption permitted. While we continue to assess the potential impact of this standard, we do not expect the adoption of this standard to have a material impact on our consolidated financial statements.

In February 2018, the FASB issued ASU 2018-02, *Income Statement-Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income,* which allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from U.S. federal tax legislation commonly referred to as the Tax Cuts and Jobs Act, which was enacted in December 2017 (the "2017 Tax Act"). ASU 2018-02 is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. While we continue to assess our adoption policy for this standard, we do not expect adoption to have a material impact on our consolidated financial statements.

In August 2017, the FASB issued ASU 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*, which expands and refines hedge accounting for both financial and non-financial risk components, aligns the recognition and presentation of the effects of hedging instruments and hedge items in the financial statements, and includes certain targeted improvements to ease the application of current guidance related to the assessment of hedge effectiveness. ASU 2017-12 is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. We are currently evaluating the anticipated impact of adopting ASU 2017-12 on our consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*, which eliminates the current tests for lease classification under U.S. GAAP and requires lessees to recognize the right-of-use assets and related lease liabilities on the balance sheet for all leases greater than one year in duration. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption of ASU 2016-02 is permitted. In July 2018, the FASB issued ASU 2018-11 to provide a transition practical expedient by allowing entities to initially apply the new leases standard at the adoption date, recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption, and not restate prior periods. We expect to adopt this as well as certain other practical expedients available to us under the new guidance. We have implemented processes and information technology tools to assist in our ongoing lease data collection and analysis. We are currently finalizing our lease portfolio analysis to determine the impact to our consolidated financial statements, and currently expect that most of our operating lease commitments will be recognized as lease liabilities and right-of-use assets upon our adoption of ASU 2016-02. We are updating our accounting policies and internal controls that will be impacted by the new guidance to ensure readiness for adoption in the first quarter of 2019.

We do not believe any other issued and not yet effective accounting standards will be relevant to our consolidated financial statements.

**9. Income Taxes.** On December 22, 2017, the 2017 Tax Act was signed into law. At December 31, 2017, we recorded a provisional net tax benefit related to the remeasurement of deferred taxes and a one-time tax expense for the transition tax. In accordance with SEC Staff Accounting Bulletin 118, income tax effects of the 2017 Tax Act may be refined upon obtaining, preparing, and/or analyzing additional information during the measurement period and such changes could be material. During the measurement period, provisional amounts may also be adjusted for the effects, if any, of interpretative guidance issued after December 31, 2017 by U.S. regulatory and standard-setting bodies. As of September 30, 2018, the amounts recorded for the 2017 Tax Act remain provisional and may be impacted by further analysis and subsequently issued guidance.

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For tax years beginning after December 31, 2017, the 2017 Tax Act introduces new provisions of U.S. taxation of certain Global Intangible Low-Taxed Income ("GILTI"). We have not yet determined our policy election with respect to whether to record deferred taxes for temporary basis differences expected to reverse as GILTI in future periods, or account for taxes on GILTI using the period cost method. We have, however, included an estimate of the current GILTI impact in our tax provision for the three and nine months ended September 30, 2018.

Our non-U.S. earnings are currently considered as indefinitely reinvested overseas. Previously, any repatriation by way of a dividend may have been subject to both U.S. federal and state income taxes, as adjusted for any non-U.S. tax credits. Under the 2017 Tax Act, such dividends should no longer be subject to U.S. federal tax. We are still analyzing how the 2017 Tax Act impacts our existing accounting position to indefinitely reinvest foreign earnings and have yet to determine whether we plan to change our position. We will record the tax effects of any change to our existing assertion in the period that we complete our analysis. If such earnings were to be distributed, any foreign withholding taxes could be material.

Our provision for income taxes for the three months ended September 30, 2018 and 2017 was a tax expense of approximately $2.8 million and $1.4 million, respectively, which resulted in an effective tax rate of 14.3% and (61.9)%, respectively. The change in the effective tax rate for the third quarter of 2018 compared to the third quarter of 2017 is primarily due to the discrete tax impact of the in-process research and development charge attributable to the IntelliMedical acquisition completed in the third quarter of 2017, which is not deductible for tax purposes.

Our provision for income taxes for the nine months ended September 30, 2018 and 2017 was a tax expense of approximately $4.5 million and $3.9 million, respectively, which resulted in an effective tax rate of 12.0% and 15.8%, respectively. The decrease in the effective income tax rate for the nine months ended September 30, 2018 compared to the corresponding period of 2017 was primarily due to a discrete tax benefit related to share-based payment awards.

**10. Revolving Credit Facility and Long-Term Debt.** Principal balances outstanding under our long-term debt obligations as of September 30, 2018 and December 31, 2017, consisted of the following (in thousands):

| | **September 30, 2018** | | **December 31, 2017** | |
|---|---|---|---|---|
| 2016 Term loan | $ | 76,250 | $ | 85,000 |
| 2016 Revolving credit loans | 126,000 | | 187,000 | |
| Collateralized debt facility | 7,000 | | 6,959 | |
| Less unamortized debt issuance costs | (383) | | (487) | |
| Total long-term debt | 208,867 | | 278,472 | |
| Less current portion | 22,000 | | 19,459 | |
| Long-term portion | $ | 186,867 | $ | 259,013 |

*2016 Term Loan and Revolving Credit Loans*

On July 6, 2016, we entered into a Second Amended and Restated Credit Agreement (as amended to date, the "Second Amended Credit Agreement"), with Wells Fargo Bank, National Association, as administrative agent, swingline lender and a lender, and Wells Fargo Securities, LLC, as sole lead arranger and sole bookrunner. In addition to Wells Fargo Bank, National Association, Bank of America, N.A., U.S. Bank, National Association, and HSBC Bank USA, National Association, are parties to the Second Amended Credit Agreement as lenders. The Second Amended Credit Agreement amends and restates in its entirety our previously outstanding Amended and Restated Credit Agreement and all amendments thereto. The Second Amended Credit Agreement was amended on September 28, 2016 to allow for a new revolving credit loan to our wholly-owned subsidiary, on March 20, 2017 to allow flexibility in how we apply net proceeds received from equity issuances to prepay outstanding indebtedness, on December 13, 2017 to increase the revolving credit commitment by $100 million up to $375 million, and on March 28, 2018 to amend certain debt covenants.

The Second Amended Credit Agreement provides for a term loan of $150 million and a revolving credit commitment up to an aggregate amount of $375 million, which includes a reserve of $25 million to make swingline loans from time to time. The term loan is payable in quarterly installments in the amounts provided in the Second Amended Credit Agreement until the maturity date of July 6, 2021, at which time the term and revolving credit loans, together with accrued interest thereon, will be due and payable. At any time prior to the maturity date, we may repay any amounts owing under all revolving credit loans, term loans, and all swingline loans in whole or in part, subject to certain minimum thresholds, without premium or penalty, other than breakage costs.

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Revolving credit loans denominated in dollars and term loans made under the Second Amended Credit Agreement bear interest, at our election, at either a Base Rate or Eurocurrency Base Rate (as such terms are defined in the Second Amended Credit Agreement) plus the applicable margin, which increases as our Consolidated Total Leverage Ratio (as defined in the Second Amended Credit Agreement) increases. Revolving credit loans denominated in an Alternative Currency (as defined in the Second Amended Credit Agreement) bear interest at the Eurocurrency rate plus the applicable margin. Swingline loans bear interest at the Base Rate plus the applicable margin. Upon an event of default, the interest rate may be increased by 2.0%. The revolving credit commitment also carries a commitment fee of 0.15% to 0.40% per annum on the unused portion.

The Second Amended Credit Agreement is collateralized by substantially all our assets. The Second Amended Credit Agreement contains covenants, representations and warranties, and other terms customary for loans of this nature. The Second Amended Credit Agreement requires that we maintain certain financial covenants, as follows:

| | Covenant Requirement | |
|---|---|---|
| Consolidated Total Leverage Ratio [1] | | |
| January 1, 2018 and thereafter | 3.5 to 1.0 | |
| Consolidated EBITDA [2] | | 1.25 to 1.0 |
| Consolidated Net Income [3] | | $0 |
| Facility Capital Expenditures [4] | | $30 million |

(1) Maximum Consolidated Total Leverage Ratio (as defined in the Second Amended Credit Agreement) as of any fiscal quarter end.

(2) Minimum ratio of Consolidated EBITDA (as defined in the Second Amended Credit Agreement and adjusted for certain expenditures) to Consolidated Fixed Charges (as defined in the Second Amended Credit Agreement) for any period of four consecutive fiscal quarters.

(3) Minimum level of Consolidated Net Income (as defined in the Second Amended Credit Agreement) for certain periods, and subject to certain adjustments.

(4) Maximum level of the aggregate amount of all Facility Capital Expenditures (as defined in the Second Amended Credit Agreement) in any fiscal year.

Additionally, the Second Amended Credit Agreement contains customary events of default and affirmative and negative covenants for transactions of this type. As of September 30, 2018, we believe we were in compliance with all covenants set forth in the Second Amended Credit Agreement.

As of September 30, 2018, we had outstanding borrowings of approximately $202.3 million under the Second Amended Credit Agreement, with available borrowings of approximately $248.4 million, based on the leverage ratio required pursuant to the Second Amended Credit Agreement. Our interest rate as of September 30, 2018 was a fixed

rate of 2.87% on $175.0 million as a result an interest rate swap (see Note 11) and a variable floating rate of 3.99% on $27.3 million. Our interest rate as of December 31, 2017 was a fixed rate of 2.68% on $175 million as a result of an interest rate swap and a variable floating rate of 2.82% on $97 million.

*Collateralized Debt Facility*

On September 3, 2018, we renewed our loan agreement with HSBC Bank whereby HSBC Bank agreed to provide us with a loan in the amount of approximately $7.0 million. The loan matures on January 10, 2019, with an extension available at our option, subject to certain conditions. The loan agreement bears interest at the six-month London Inter-Bank Offered Rate ("LIBOR") plus 1.0%. The loan is secured by assets having a value not less than the currently outstanding loan balance. The loan contains covenants, representations and warranties and other terms customary for loans of this nature. As of September 30, 2018, our interest rate on the loan was a variable rate of 3.12%.

*Future Payments*

Future minimum principal payments on our long-term debt as of September 30, 2018, are as follows (in thousands):

| **Years Ending December 31** | **Future Minimum Principal Payments** | |
|---|---|---|
| Remaining 2018 | $ | 3,750 |
| 2019 | 22,000 | |
| 2020 | 17,500 | |
| 2021 | 166,000 | |
| Total future minimum principal payments | $ | 209,250 |

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**11. Derivatives**

**General.** Our earnings and cash flows are subject to fluctuations due to changes in interest rates and foreign currency exchange rates, and we seek to mitigate a portion of these risks by entering into derivative contracts. The derivatives we use are interest rate swaps and foreign currency forward contracts. We recognize derivatives as either assets or liabilities at fair value in the accompanying consolidated balance sheets, regardless of whether or not hedge accounting is applied. We report cash flows arising from our hedging instruments consistent with the classification of cash flows from the underlying hedged items. Accordingly, cash flows associated with our derivative programs are classified as operating activities in the accompanying consolidated statements of cash flows.

We formally document, designate and assess the effectiveness of transactions that receive hedge accounting initially and on an ongoing basis. Changes in the fair value of derivatives that qualify for hedge accounting treatment are recorded, net of applicable taxes, in accumulated other comprehensive income (loss), a component of stockholders' equity in the accompanying consolidated balance sheets. For the ineffective portions of qualifying hedges, the change in fair value is recorded through earnings in the period of change. Changes in the fair value of derivatives not designated as hedging instruments are recorded in earnings throughout the term of the derivative.

**Interest Rate Risk.** A portion of our debt bears interest at variable interest rates and, therefore, we are subject to variability in the cash paid for interest expense. In order to mitigate a portion of this risk, we use a hedging strategy to reduce the variability of cash flows in the interest payments associated with a portion of the variable-rate debt outstanding under our Second Amended Credit Agreement that is solely due to changes in the benchmark interest rate.

*Derivatives Designated as Cash Flow Hedges*

On August 5, 2016, we entered into a pay-fixed, receive-variable interest rate swap with a current notional amount of $175.0 million with Wells Fargo to fix the one-month LIBOR rate at 1.12%. The variable portion of the interest rate swap is tied to the one-month LIBOR rate (the benchmark interest rate). On a monthly basis, the interest rates under both the interest rate swap and the underlying debt reset, the swap is settled with the counterparty, and interest is paid. The interest rate swap is scheduled to expire on July 6, 2021.

At September 30, 2018 and December 31, 2017, our interest rate swap qualified as a cash flow hedge. The fair value of our interest rate swap at September 30, 2018 was an asset of approximately $8.3 million, which was partially offset by approximately $2.1 million in deferred taxes. The fair value of our interest rate swap at December 31, 2017 was an asset of approximately $5.7 million, which was offset by approximately $1.5 million in deferred taxes.

**Foreign Currency Risk**. We operate on a global basis and are exposed to the risk that our financial condition, results of operations, and cash flows could be adversely affected by changes in foreign currency exchange rates. To reduce the potential effects of foreign currency exchange rate movements on net earnings, we enter into derivative financial instruments in the form of foreign currency exchange forward contracts with major financial institutions. Our policy is to enter into foreign currency derivative contracts with maturities of up to two years. We are primarily exposed to foreign currency exchange rate risk with respect to transactions and balances denominated in Euros, British Pounds, Chinese Renminbi, Mexican Pesos, Brazilian Reals, Australian Dollars, Hong Kong Dollars, Swiss Francs, Swedish Krona, Canadian Dollars, Danish Krone, Japanese Yen, Korean Won, and Singapore Dollars. We do not use derivative financial instruments for trading or speculative purposes. We are not subject to any credit risk contingent features related to our derivative contracts, and counterparty risk is managed by allocating derivative contracts among several major financial institutions.

*Derivatives Designated as Cash Flow Hedges*

For derivative instruments that are designated and qualify as cash flow hedges, the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income (loss) and reclassified into earnings in the same line item associated with the forecasted transaction and in the same period or periods during which the hedged transaction affects earnings. The remaining gain or loss on the derivative instrument in excess of the cumulative change in the present value of future cash flows of the hedged item, if any (i.e., the ineffective portion) or hedge components excluded from the assessment of effectiveness, are recognized in earnings during the current period. We enter into forward contracts on various foreign currencies to manage the risk associated with forecasted exchange rates which impact revenues, cost of sales, and operating

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expenses in various international markets. The objective of the hedges is to reduce the variability of cash flows associated with the forecasted purchase or sale of the associated foreign currencies.

We enter into approximately 150 cash flow foreign currency hedges every month. As of September 30, 2018, we had entered into foreign currency forward contracts, which qualified as cash flow hedges, with the following notional amounts (in thousands and in local currencies):

| Currency | Symbol | Forward Notional Amount |
|---|---|---|
| Canadian Dollar | CAD | 2,460 |
| Swiss Franc | CHF | 1,215 |
| Chinese Renminbi | CNY | 60,000 |
| Danish Krone | DKK | 10,835 |
| Euro | EUR | 12,270 |
| British Pound | GBP | 3,355 |
| Japanese Yen | JPY | 330,000 |
| Mexican Peso | MXN | 93,575 |
| Swedish Krona | SEK | 12,780 |

*Derivatives Not Designated as Cash Flow Hedges*

We forecast our net exposure in various receivables and payables to fluctuations in the value of various currencies, and we enter into foreign currency forward contracts to mitigate that exposure. We enter into approximately 20 foreign currency fair value hedges every month. As of September 30, 2018, we had entered into foreign currency forward contracts related to those balance sheet accounts, with the following notional amounts (in thousands and in local currencies):

| Currency | Symbol | Forward Notional Amount |
|---|---|---|
| Australian Dollar | AUD | 11,150 |
| Brazilian Real | BRL | 8,500 |
| Canadian Dollar | CAD | 3,098 |
| Swiss Franc | CHF | 255 |
| Chinese Renminbi | CNY | 95,228 |
| Danish Krone | DKK | 2,885 |
| Euro | EUR | 25,861 |
| | GBP | 1,584 |

| | | |
|---|---|---|
| British Pound | | |
| Hong Kong Dollar | HKD | 11,000 |
| Japanese Yen | JPY | 260,000 |
| Korean Won | KRW | 2,700,000 |
| Mexican Peso | MXN | 18,700 |
| Swedish Krona | SEK | 10,536 |
| Singapore Dollar | SGD | 6,900 |

**Balance Sheet Presentation of Derivatives.** As of September 30, 2018, and December 31, 2017, all derivatives, both those designated as hedging instruments and those that were not designated as hedging instruments, were recorded gross at fair value on our consolidated balance sheets. We are not subject to any master netting agreements.

The fair value of derivative instruments on a gross basis is as follows (in thousands):
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| | Balance Sheet Location | Fair Value | |
|---|---|---|---|
| | | September 30, 2018 | December 31, 2017 |
| ***Derivatives designated as hedging instruments*** | | | |
| *Assets* | | | |
| Interest rate swap | Other assets (long-term) | $ 8,284 | $ 5,749 |
| Foreign currency forward contracts | Prepaid expenses and other assets | 813 | 363 |
| Foreign currency forward contracts | Other assets (long-term) | 161 | 35 |
| *Liabilities* | | | |
| Foreign currency forward contracts | Accrued expenses | (240) | (468) |
| Foreign currency forward contracts | Other long-term obligations | (56) | (82) |
| ***Derivatives not designated as hedging instruments*** | | | |
| *Assets* | | | |
| Foreign currency forward contracts | | | |