

WRIGHT MEDICAL GROUP INC

Form 10-Q

November 12, 2003

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2003

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 000-32883

WRIGHT MEDICAL GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction
of incorporation)

13-4088127
(IRS employer
identification number)

5677 Airline Road
Arlington, Tennessee
(Address of principal executive offices)

38002
(Zip code)

Registrant's telephone number

(901) 867-9971

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes No

As of November 6, 2003, a total of 32,990,313 shares of common stock, par value \$.01 per share, of the registrant were outstanding.

TABLE OF CONTENTS

PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CONDENSED CONSOLIDATED BALANCE SHEETS

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOW

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

ITEM 4. CONTROLS AND PROCEDURES

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

ITEM 5. OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

SIGNATURES

EX-10.1 CREDIT AGREEMENT AMENDMENT NO. 3 09/11/03

EX-31.1 SECTION 302 CERTIFICATION OF THE CEO

EX-31.2 SECTION 302 CERTIFICATION OF THE CFO

EX-32 906 CERTIFICATIONS OF THE CEO AND CFO

Table of Contents**WRIGHT MEDICAL GROUP, INC.****TABLE OF CONTENTS**

	Page Number
PART I FINANCIAL INFORMATION	
Item 1 - Financial Statements	
Condensed Consolidated Balance Sheets as of September 30, 2003 and December 31, 2002	1
Condensed Consolidated Statements of Operations for the three and nine month periods ended September 30, 2003 and 2002	2
Condensed Consolidated Statements of Cash Flow for the nine months ended September 30, 2003 and 2002	3
Notes to Condensed Consolidated Financial Statements	4
Item 2 - Management's Discussion and Analysis of Results of Operations and Financial Condition	9
Item 3 - Quantitative and Qualitative Disclosures About Market Risk	17
Item 4 - Controls and Procedures	18
PART II OTHER INFORMATION	
Item 1 - Legal Proceedings	19
Item 2 - Changes in Securities and Use of Proceeds	19
Item 3 - Defaults Upon Senior Securities	19
Item 4 - Submission of Matters to a Vote of Security Holders	19
Item 5 - Other Information	19
Item 6 - Exhibits and Reports on Form 8-K	20
SIGNATURES	22

SAFE-HARBOR STATEMENT

This quarterly report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, as amended. All statements made in this quarterly report, other than statements of historical fact, are forward-looking statements. Forward-looking statements reflect management's current knowledge, assumptions, beliefs, estimates, and expectations and express management's current views of future performance, results, and trends. We wish to caution readers that actual results might differ materially from those described in the forward-looking statements. Forward-looking statements are subject to a number of risks and uncertainties, including the factors discussed in our filings with the Securities and Exchange Commission (including those described in Item 7 of our annual report on Form 10-K for the year ended December 31, 2002, under the heading, "Factors Affecting Future Operating Results," and in this quarterly report) which could cause our actual results to materially differ from those described in the forward-looking statements. Although we believe that the forward-looking statements are accurate, there can be no assurance that any forward-looking statement will prove to be accurate. A forward-looking statement should not be regarded as a representation by us that the results described therein will be achieved. We wish to caution readers not to place undue reliance on any forward-looking statement. The forward-looking statements are made as of the date of this quarterly report. We assume no obligation to update any forward-looking statement after this date.

Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS**

WRIGHT MEDICAL GROUP, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

	<u>September 30,</u> <u>2003</u>	<u>December 31,</u> <u>2002</u>
	(unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 65,187	\$ 51,373
Accounts receivable, net	45,267	39,571
Inventories	61,166	55,628
Prepaid expenses	6,487	3,999
Deferred income taxes	10,555	16,476
Other current assets	2,772	4,567
	<hr/>	<hr/>
Total current assets	191,434	171,614
Property, plant and equipment, net	61,553	59,215
Goodwill	10,493	9,532
Intangible assets, net	18,639	17,376
Deferred income taxes	14,609	14,297
Other assets	1,516	2,149
	<hr/>	<hr/>
	\$ 298,244	\$ 274,183
	<hr/>	<hr/>
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 11,657	\$ 9,878
Accrued expenses and other current liabilities	35,965	29,878
Current portion of long-term obligations	5,778	5,676
	<hr/>	<hr/>
Total current liabilities	53,400	45,432
Long-term obligations	13,828	16,586
Deferred income taxes	5,719	6,435
Other liabilities	505	731
	<hr/>	<hr/>
Total liabilities	73,452	69,184
	<hr/>	<hr/>
Commitments and Contingencies (Note 9)		
Stockholders' equity:		
Common stock, voting, \$.01 par value, shares authorized 70,000,000; shares issued and outstanding 32,957,830 in 2003, 32,712,374 in 2002	330	327
Additional paid-in capital	262,322	260,640
Deferred compensation	(2,014)	(3,164)
Accumulated other comprehensive income	10,591	4,283
Accumulated deficit	(46,437)	(57,087)

Edgar Filing: WRIGHT MEDICAL GROUP INC - Form 10-Q

Total stockholders equity	<u>224,792</u>	<u>204,999</u>
	<u>\$298,244</u>	<u>\$274,183</u>

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

Table of Contents

WRIGHT MEDICAL GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
Net sales	\$59,268	\$46,086	\$180,042	\$148,563
Cost of sales	15,453	11,976	48,379	40,968
Gross profit	43,815	34,110	131,663	107,595
Operating expenses:				
Selling, general and administrative	32,292	26,338	94,560	79,625
Research and development	4,397	2,763	11,840	7,889
Amortization of intangible assets	900	1,076	2,627	2,850
Stock-based expense ¹	482	419	1,311	1,316
Acquired in-process research and development costs (Note 2)			4,558	
Arbitration settlement award (Note 8)				(4,200)
Total operating expenses	38,071	30,596	114,896	87,480
Income from operations	5,744	3,514	16,767	20,115
Interest expense (income), net	274	(79)	852	693
Other (income) expense, net	(155)	145	(666)	(988)
Income before income taxes	5,625	3,448	16,581	20,410
Provision for income taxes	1,974	926	5,931	5,725
Net income	\$ 3,651	\$ 2,522	\$ 10,650	\$ 14,685
Net income per common share (Note 6):				
Basic	\$ 0.11	\$ 0.08	\$ 0.32	\$ 0.46
Diluted	\$ 0.11	\$ 0.07	\$ 0.31	\$ 0.43
Weighted-average number of common shares outstanding-basic	32,932	32,496	32,807	31,612
Weighted-average number of common shares outstanding-diluted	34,695	34,745	34,378	34,025

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

1 Amounts presented include selling, general and administrative expenses of \$455 and \$392 for the three month periods ended September 30, 2003 and 2002, respectively, and \$1,232 and \$1,233 for the nine month periods ended September 30, 2003 and 2002, respectively. Amounts presented also include research and development expenses of \$27 for both of the three month periods ended September 30, 2003 and 2002 and \$79 and \$83 for the nine month periods ended September 30, 2003 and 2002, respectively.

Table of Contents

WRIGHT MEDICAL GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOW
(In thousands)
(unaudited)

	Nine Months Ended September 30,	
	2003	2002
Operating activities:		
Net income	\$ 10,650	\$ 14,685
Non-cash items included in net income:		
Depreciation	10,317	10,083
Amortization of intangible assets	2,627	2,850
Amortization of deferred financing costs	196	196
Deferred income taxes	5,170	5,401
Stock-based expense	1,311	1,316
Acquired in-process research and development costs	4,558	
Other	(51)	367
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	(2,606)	(2,450)
Inventories	(1,955)	(11,559)
Other current assets	(1,826)	(3,327)
Accounts payable	1,174	455
Accrued expenses and other liabilities	4,503	(5,236)
	34,068	12,781
Investing activities:		
Capital expenditures	(10,658)	(13,290)
Purchase of tangible and intangible assets (Note 2)	(7,779)	(3,629)
Other	68	
	(18,369)	(16,919)
Financing activities:		
Issuance of common stock, net of offering costs	1,204	51,311
Payments of bank and other borrowings	(3,358)	(1,630)
	(2,154)	49,681
Effect of exchange rates on cash and cash equivalents	269	524
	13,814	46,067
Cash and cash equivalents, beginning of period	51,373	2,770
	\$ 65,187	\$ 48,837

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

Table of Contents

**WRIGHT MEDICAL GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

1. Summary of Significant Accounting Policies

BASIS OF PRESENTATION

The unaudited condensed consolidated interim financial statements of Wright Medical Group, Inc. (the Company) have been prepared in accordance with accounting principles generally accepted in the United States (U.S.) for interim financial information and the instructions to Quarterly Report on Form 10-Q and Rule 10-01 of Regulation S-X. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed, or omitted, pursuant to these rules and regulations. In the opinion of management, these statements reflect all adjustments necessary for a fair presentation of the interim financial statements. All such adjustments are of a normal and recurring nature. The results of operations for any interim period are not necessarily indicative of results for the full fiscal year. These unaudited condensed consolidated interim financial statements should be read in conjunction with the Company's consolidated financial statements and related notes included in the Company's annual report on Form 10-K for the year ended December 31, 2002, as filed with the Securities and Exchange Commission (SEC).

The accompanying unaudited condensed consolidated interim financial statements include the accounts of the Company and its wholly-owned domestic and international subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

RECENT ACCOUNTING PRONOUNCEMENTS

The Company adopted Statement of Financial Accounting Standards (SFAS) No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*, effective July 1, 2003. SFAS No. 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. The Company has applied the provisions of SFAS No. 149 prospectively. The adoption of SFAS No. 149 did not have a material impact on the Company's financial position, results of operations, or cash flows.

The Company adopted SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity*, effective July 1, 2003. SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. The adoption of SFAS No. 150 did not have a material impact on the Company's financial position, results of operations, or cash flows.

In November 2002, the Financial Accounting Standards Board (FASB) issued Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others, an interpretation of FASB Statements No. 5, 57 and 107 and a rescission of FASB Interpretation No. 34*. Interpretation No. 45 elaborates on the disclosures a guarantor must make in its interim and annual financial statements about its obligations under guarantees issued. Interpretation No. 45 also clarifies that a guarantor is required to recognize, at inception of a guarantee, a liability for the fair value of the obligation undertaken. The initial recognition and measurement provisions of Interpretation No. 45 apply to guarantees issued or modified after December 31, 2002. To date the Company has not entered into or modified any such guarantees.

The Company adopted FASB Interpretation No. 46, *Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51*, effective February 1, 2003. Interpretation No. 46 requires the primary beneficiary of a variable interest entity (VIE) to consolidate the VIE under certain circumstances. Interpretation No. 46 is effective for all new VIEs created or acquired after January 31, 2003. For VIEs created or acquired prior to February 1, 2003, Interpretation No. 46 must be applied for the first interim or annual period beginning after December 15, 2003. The adoption of Interpretation No. 46 did not have any impact on the Company's financial position, results of operations, or cash flows.

STOCK OPTION PLANS

At September 30, 2003, the Company had two stock-based employee compensation plans. The Company accounts for those plans under the intrinsic value method in accordance with the provisions of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*. Accordingly, compensation cost related to stock option grants to employees has been recognized only to the extent that

Table of Contents

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

1. Summary of Significant Accounting Policies (continued)

the fair market value of the stock exceeds the exercise price of the stock option at the date of grant. Nonemployee stock-based compensation is accounted for in accordance with SFAS No. 123, *Accounting for Stock-Based Compensation*.

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
In thousands, except per share amounts				
Net income, as reported	\$ 3,651	\$ 2,522	\$ 10,650	\$ 14,685
Add: Stock-based employee compensation cost recognized under intrinsic value method, net of tax	239	284	713	853
Less: Stock-based employee compensation expense determined under fair value based method, net of tax	(1,031)	(922)	(2,945)	(2,529)
Pro forma net income	<u>\$ 2,859</u>	<u>\$ 1,884</u>	<u>\$ 8,418</u>	<u>\$ 13,009</u>
Income per share:				
Basic, as reported	<u>\$ 0.11</u>	<u>\$ 0.08</u>	<u>\$ 0.32</u>	<u>\$ 0.46</u>
Basic, pro forma	<u>\$ 0.09</u>	<u>\$ 0.06</u>	<u>\$ 0.26</u>	<u>\$ 0.41</u>
Diluted, as reported	<u>\$ 0.11</u>	<u>\$ 0.07</u>	<u>\$ 0.31</u>	<u>\$ 0.43</u>
Diluted, pro forma	<u>\$ 0.08</u>	<u>\$ 0.05</u>	<u>\$ 0.25</u>	<u>\$ 0.39</u>

2. Acquisition of Assets

On March 5, 2003, the Company completed an acquisition of certain assets from Gliatech Inc. related to its ADCON® Gel technology for \$8.4 million in cash and a royalty contingent upon future product sales. The Company paid \$840,000 of the purchase price as a deposit in the fourth quarter of 2002, and \$3.4 million in the first quarter of 2003. The remaining \$4.2 million was paid in the second quarter of 2003 upon final receipt of all assets. The following table summarizes the allocation of the purchase price (in thousands):

Inventories	\$ 1,312
Property, plant and equipment	160
Acquired in-process research and development	4,558
Intangible assets:	
Completed Technology	1,575
Trademarks	554
Other	286

\$8,445

In connection with the acquisition of these assets, the Company engaged an independent third party to conduct a valuation of the intangible assets acquired. The value assigned to acquired in-process research and development (IPRD) was \$4.6 million of the purchase price. Accordingly, this amount was expensed in the three-month period ended March 31, 2003. The value assigned to IPRD was determined by estimating the costs to develop the IP