RESPIRONICS INC
Form 10-Q
May 17, 2004

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-Q

(Mark One)

x **Quarterly Report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934**

for the quarterly period ended March 31, 2004

or

¨ **Transition Report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934**

for the transition period from ______ to ______

Commission File No. 000-16723

RESPIRONICS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**25-1304989**

(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**
1010 Murry Ridge Lane	
Murrysville, Pennsylvania	**15668-8525**
(Address of principal executive offices)	**(Zip Code)**

724-387-5200

(Registrant s Telephone Number, including area code)

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

As of April 30, 2004, there were 38,324,180 shares of Common Stock of the registrant outstanding, of which 3,495,815 were held in treasury.

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RESPIRONICS, INC.

Independent Accountants Review Report

Board of Directors

Respironics, Inc. and Subsidiaries

We have reviewed the accompanying consolidated balance sheet of Respironics, Inc. and Subsidiaries as of March 31, 2004, and the related consolidated statements of operations for the three-month and nine-month periods ended March 31, 2004 and 2003, and the condensed consolidated statements of cash flows for the nine-month periods ended March 31, 2004 and 2003. These financial statements are the responsibility of the Company s management.

We conducted our reviews in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data, and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States, which will be performed for the full year with the objective of expressing an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying consolidated financial statements referred to above for them to be in conformity with accounting principles generally accepted in the United States.

We have previously audited, in accordance with auditing standards generally accepted in the United States, the consolidated balance sheet of Respironics, Inc. and Subsidiaries as of June 30, 2003, and the related consolidated statements of operations, shareholders equity, and cash flows for the year then ended not presented herein and in our report dated July 22, 2003 we expressed an unqualified opinion on those consolidated financial statements and included an explanatory paragraph for the Company adopting Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, effective July 1, 2002. In our opinion, the information set forth in the accompanying consolidated balance sheet as of June 30, 2003 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Ernst & Young LLP

Pittsburgh, Pennsylvania

April 20, 2004

CONSOLIDATED BALANCE SHEETS

RESPIRONICS, INC. AND SUBSIDIARIES

	(Unaudited) March 31 2004	June 30 2003
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 157,767,302	$ 95,900,114
Trade accounts receivable	136,459,841	128,126,999
Inventories	86,624,489	83,986,140
Prepaid expenses and other current assets	10,242,955	7,890,194
Deferred income tax benefits	28,393,270	24,111,838
TOTAL CURRENT ASSETS	419,487,857	340,015,285
PROPERTY, PLANT AND EQUIPMENT		
Land	2,931,182	2,868,310
Buildings	17,257,815	16,888,036
Production and office equipment	240,140,064	218,839,491
Leasehold improvements	7,987,003	7,630,418
	268,316,064	246,226,255
Less allowances for depreciation and amortization	157,743,361	147,546,282
	110,572,703	98,679,973
OTHER ASSETS	38,723,168	34,591,712
GOODWILL	109,793,947	108,909,352
TOTAL ASSETS	$ 678,577,675	$ 582,196,322
LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 49,995,929	$ 40,531,413
Accrued expenses and other current liabilities	84,864,700	68,389,269
Current portion of long-term obligations	11,871,122	18,307,876
TOTAL CURRENT LIABILITIES	146,731,751	127,228,558
LONG-TERM OBLIGATIONS	24,551,380	16,513,243
OTHER NON-CURRENT LIABILITIES	10,392,318	11,585,202
SHAREHOLDERS EQUITY		
Common Stock, $.01 par value; authorized 100,000,000 shares; issued 38,311,800 shares at March 31, 2004 and 37,505,700 shares at June 30, 2003; outstanding 34,815,985 shares at March 31, 2004 and 33,957,221 shares at June 30, 2003	383,118	375,057
Additional capital	246,690,209	226,884,681

Accumulated other comprehensive income (loss)	892,884	(3,557,902)
Retained earnings	290,377,311	245,031,878
Treasury stock	(41,441,296)	(41,864,395)
TOTAL SHAREHOLDERS EQUITY	496,902,226	426,869,319
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 678,577,675	$ 582,196,322

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

RESPIRONICS, INC. AND SUBSIDIARIES

	Three months ended March 31		Nine months ended March 31	
	2004	**2003**	**2004**	**2003**
Net sales	$ 196,731,854	$ 161,858,391	$ 553,107,884	$ 452,381,799
Cost of goods sold	90,245,455	79,131,099	261,085,894	225,188,730
	106,486,399	82,727,292	292,021,990	227,193,069
General and administrative expenses (excluding acquisition earn-out expenses)	25,524,277	21,457,561	77,524,517	60,124,998
Acquisition earn-out expenses	3,376,875	184,419	5,156,125	553,257
Sales, marketing and commission expenses	36,901,588	29,627,879	107,222,034	84,439,604
Research and development expenses	7,615,763	5,817,370	20,547,970	16,825,341
Contribution to foundation	0	0	1,500,000	0
Restructuring and acquisition-related expenses	2,884,655	3,182,224	8,775,281	13,390,703
Other (income) expense, net	(280,934)	87,774	(1,995,530)	386,578
	76,022,224	60,357,227	218,730,397	175,720,481
INCOME BEFORE INCOME TAXES	30,464,175	22,370,065	73,291,593	51,472,588
Income taxes	12,170,259	8,453,027	27,946,160	19,456,638
NET INCOME	$ 18,293,916	$ 13,917,038	$ 45,345,433	$ 32,015,950
Basic earnings per share	$ 0.53	$ 0.41	$ 1.33	$ 0.96
Basic shares outstanding	34,530,374	33,621,676	34,222,097	33,483,453
Diluted earnings per share	$ 0.51	$ 0.41	$ 1.29	$ 0.93
Diluted shares outstanding	35,523,741	34,308,200	35,158,296	34,523,738

See notes to consolidated financial statements.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

RESPIRONICS, INC. AND SUBSIDIARIES

	Nine Months Ended March 31	
	2004	**2003**
OPERATING ACTIVITIES		
Net income	$ 45,345,433	$ 32,015,950
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	31,832,477	32,593,724
Changes in operating assets and liabilities:		
Accounts receivable	(7,656,020)	(8,257,443)
Inventories	(2,139,446)	2,284,065
Other operating assets and liabilities	23,945,345	13,361,830
NET CASH PROVIDED BY OPERATING ACTIVITIES	91,327,789	71,998,126
INVESTING ACTIVITIES		
Purchase of property, plant and equipment	(36,419,582)	(30,794,219)
Acquisition of business	(4,470,423)	(4,000,049)
Additional purchase price and transaction costs for previously acquired businesses	(1,985,458)	(1,206,592)
NET CASH USED BY INVESTING ACTIVITIES	(42,875,463)	(36,000,860)
FINANCING ACTIVITIES		
Net decrease in borrowings	(1,966,081)	(31,521,620)
Issuance of common stock	15,380,943	5,146,562
NET CASH PROVIDED (USED) BY FINANCING ACTIVITIES	13,414,862	(26,375,058)
INCREASE IN CASH AND CASH EQUIVALENTS	61,867,188	9,622,208
Cash and cash equivalents at beginning of period	95,900,114	62,334,684
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 157,767,302	$ 71,956,892

See notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

RESPIRONICS, INC. AND SUBSIDIARIES

March 31, 2004

NOTE A BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months and nine months ended March 31, 2004 are not necessarily indicative of the results that may be expected for the year ended June 30, 2004. The amounts and information as of June 30, 2003 set forth in the consolidated balance sheet and notes to the consolidated financial statements that follow was derived from the Company s Annual Report on Form 10-K for the year ended June 30, 2003. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company s Annual Report on Form 10-K for the year ended June 30, 2003.

NOTE B ACCOUNTS RECEIVABLE

Trade accounts receivable in the consolidated balance sheets is net of allowances for doubtful accounts of $14,831,000 as of March 31, 2004 and $12,495,000 as of June 30, 2003.

NOTE C INVENTORIES

The composition of inventories is as follows:

	March 31 2004	**June 30 2003**
Raw materials	$ 23,231,000	$ 18,091,000
Work-in-process	8,086,000	8,727,000
Finished goods	55,307,000	57,168,000
	$ 86,624,000	$ 83,986,000

NOTE D GOODWILL

The Company performed its annual impairment test as of December 31, 2003 and determined that no impairment exists. The Company will update this annual test as of December 31 in future years, and on an interim basis as determined necessary in accordance with Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets.

NOTE E DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Company s functional currency is the U.S. Dollar, and a substantial majority of the Company s sales, expenses, and cash flows are transacted in U.S. Dollars. The Company also does business in various foreign currencies, primarily the Japanese Yen, the Euro, the Hong Kong Dollar and the Chinese Yuan. As part of the Company s risk management strategy, management put in place a hedging program beginning on July 1, 2003 under which the Company enters into foreign currency option and forward contracts to hedge a portion of cash flows denominated in Japanese Yen.

On July 1, 2003 the Company acquired foreign currency option and forward contracts to hedge a portion of forecasted cash flows and recognized foreign currency transactions denominated in Japanese Yen. These foreign currency option and forward contracts have notional amounts of approximately $10,559,000 as of March 31, 2004 and mature at various dates through June 30, 2004. As of March 31, 2004, the fair market value of the contracts resulted in an accrued cost of $414,000, which is recorded in accrued expenses and other current liabilities.

These contracts are entered into to reduce the risk that the Company s earnings and cash flows, resulting from certain forecasted and recognized currency transactions, will be affected by changes in foreign currency exchange rates. However, the Company may be impacted by changes in foreign exchange rates related to the portion of the forecasted transactions that is not hedged. The success of the hedging program depends, in part, on forecasts of the Company s transactions in Japanese Yen. Hedges are placed for periods consistent with identified exposures, but not longer than the end of the year for which the Company has substantially completed its annual business plan.

The Company may experience unanticipated foreign currency exchange gains or losses to the extent that there are timing differences between forecasted and actual activity during periods of currency volatility. However, since the critical terms of contracts designated as cash flow hedges are the same as the underlying forecasted and recognized currency transactions, changes in fair value of the contracts should be highly effective in offsetting the present value of changes in the expected cash flows from the forecasted and recognized currency transactions. The ineffective portion of changes in the fair value of contracts designated as hedges, if any, is recognized immediately in earnings. The Company did not recognize material gains or losses resulting from either hedge ineffectiveness or changes in forecasted transactions during the three-month and nine-month periods ended March 31, 2004.

The effective portion of any changes in the fair value of the derivative instruments, designated as cash flow hedges, is recorded in other comprehensive income (loss) (OCI) until the hedged forecasted transaction occurs or the recognized currency transaction affects earnings. Once the forecasted transaction occurs or the recognized currency transaction affects earnings, the effective portion of any related gains or losses on the cash flow hedge is reclassified from OCI to earnings. In the event the hedged forecasted transaction does not occur, or it becomes probable that it will not occur, the ineffective portion of any gain or loss on the related cash flow hedge would be reclassified from OCI to earnings at that time.

For the three-month and nine-month periods ended March 31, 2004, the Company recognized net losses related to designated cash flow hedges in the amount of $209,000 and $519,000, respectively. These amounts are classified with other (income) expense, net in the consolidated statement of operations. During the three-month and nine-month periods ended March 31, 2004, the derivative losses were more than offset by realized and unrealized currency gains on the cash flows being hedged, which are also classified with other (income) expense, net in the consolidated statement of operations. As of March 31, 2004, a loss of $5,000 was included in OCI. This loss is expected to be charged to earnings during the quarter ended June 30, 2004 as the hedged transactions occur, and it is expected that the loss will be more than offset by currency gains on the items being hedged.

NOTE F COMMITMENTS AND CONTINGENCIES

Litigation:

The Company is, as a normal part of its business operations, a party to legal proceedings in addition to those previously described in filings of the Company. Legal counsel has been retained for each proceeding and none of these proceedings is expected to have a material adverse impact on the Company s results of operations or financial condition.

Contingent Obligations Under Recourse Provisions:

In connection with customer leasing programs, the Company uses independent leasing companies to provide financing to certain