

GREATBATCH, INC.
Form 10-Q
November 12, 2014
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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 October 3, 2014
Commission File Number 1-16137

GREATBATCH, INC.
(Exact name of Registrant as specified in its charter)

Delaware
(State of
Incorporation)
2595 Dallas Parkway
Suite 310
Frisco, Texas 75034
(Address of principal executive offices)
(716) 759-5600
(Registrant’s telephone number, including area code)

16-1531026
(I.R.S. Employer
Identification No.)

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

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company

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

The number of shares outstanding of the Company’s common stock, \$0.001 par value per share, as of November 12, 2014 was: 24,995,025 shares.

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Greatbatch, Inc.

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PART I—FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

GREATBATCH, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS—Unaudited

(in thousands except share and per share data)

	As of October 3, 2014	January 3, 2014
Assets		
Current assets:		
Cash and cash equivalents	\$61,582	\$35,465
Accounts receivable, net of allowance for doubtful accounts of \$1.6 million in 2014 and \$2.0 million in 2013	121,615	113,679
Inventories	128,727	118,358
Refundable income taxes	—	2,306
Deferred income taxes	5,890	6,008
Prepaid expenses and other current assets	9,121	6,717
Total current assets	326,935	282,533
Property, plant and equipment, net	142,336	145,773
Amortizing intangible assets, net	68,763	76,122
Indefinite-lived intangible assets	20,288	20,288
Goodwill	354,583	346,656
Deferred income taxes	2,933	2,933
Other assets	15,449	16,398
Total assets	\$931,287	\$890,703
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$44,989	\$46,508
Income taxes payable	2,559	—
Deferred income taxes	613	613
Accrued expenses	41,798	44,681
Total current liabilities	89,959	91,802
Long-term debt	190,000	197,500
Deferred income taxes	50,593	52,012
Other long-term liabilities	3,673	7,334
Total liabilities	334,225	348,648
Stockholders' equity:		
Preferred stock, \$0.001 par value, authorized 100,000,000 shares; no shares issued or outstanding in 2014 or 2013	—	—
Common stock, \$0.001 par value, authorized 100,000,000 shares; 24,958,994 shares issued and 24,942,689 shares outstanding in 2014; 24,459,153 shares issued and 24,422,555 shares outstanding in 2013	25	24
Additional paid-in capital	360,435	344,915
Treasury stock, at cost, 16,305 shares in 2014 and 36,598 shares in 2013	(720)	(1,232)
Retained earnings	225,272	183,990
Accumulated other comprehensive income	12,050	14,358
Total stockholders' equity	597,062	542,055
Total liabilities and stockholders' equity	\$931,287	\$890,703

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

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GREATBATCH, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
 AND COMPREHENSIVE INCOME — Unaudited
 (in thousands except per share data)

	Three Months Ended		Nine Months Ended		
	October 3, 2014	September 27, 2013	October 3, 2014	September 27, 2013	
Sales	\$ 171,699	\$ 167,730	\$ 518,061	\$ 487,326	
Cost of sales	113,581	111,853	343,877	325,398	
Gross profit	58,118	55,877	174,184	161,928	
Operating expenses:					
Selling, general and administrative expenses	22,121	21,569	65,753	63,909	
Research, development and engineering costs, net	13,638	13,806	39,962	38,983	
Other operating expenses, net	6,176	3,500	10,223	10,560	
Total operating expenses	41,935	38,875	115,938	113,452	
Operating income	16,183	17,002	58,246	48,476	
Interest expense	1,051	1,515	3,208	9,948	
Other (income) expense, net	(3,768)	) (57	) (4,055	) 907
Income before provision for income taxes	18,900	15,544	59,093	37,621	
Provision for income taxes	4,888	4,473	17,811	11,135	
Net income	\$ 14,012	\$ 11,071	\$ 41,282	\$ 26,486	
Earnings per share:					
Basic	\$ 0.56	\$ 0.46	\$ 1.67	\$ 1.11	
Diluted	\$ 0.54	\$ 0.44	\$ 1.60	\$ 1.06	
Weighted average shares outstanding:					
Basic	24,899	24,047	24,784	23,904	
Diluted	25,923	25,188	25,850	25,017	
Comprehensive Income					
Net income	\$ 14,012	\$ 11,071	\$ 41,282	\$ 26,486	
Other comprehensive income (loss):					
Foreign currency translation gain (loss)	(3,211	) 3,579	(2,422	) 1,147
Net change in cash flow hedges, net of tax	(49) (403) 114	(365)
Defined benefit plan liability adjustment, net of tax	—	—	—	597	
Other comprehensive income (loss)	(3,260	) 3,176	(2,308	) 1,379
Comprehensive income	\$ 10,752	\$ 14,247	\$ 38,974	\$ 27,865	

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

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GREATBATCH, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS—Unaudited

(in thousands)

	Nine Months Ended	
	October 3, 2014	September 27, 2013
Cash flows from operating activities:		
Net income	\$41,282	\$26,486
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	27,943	26,658
Debt related amortization included in interest expense	580	6,171
Stock-based compensation	10,531	11,413
Other (gains) losses	(7,191	) 184
Deferred income taxes	(3,000	) (31,197
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	(8,460	) (9,901
Inventories	(7,111	) (15,999
Prepaid expenses and other current assets	(23	) 1,010
Accounts payable	(1,311	) (7,220
Accrued expenses	(3,627	) (1,732
Income taxes payable	5,070	10,202
Net cash provided by operating activities	54,683	16,075
Cash flows from investing activities:		
Acquisition of property, plant and equipment	(16,029	) (14,953
Proceeds from sale of orthopaedic product lines (Note 9)	2,655	3,228
(Purchase of) proceeds from sale of cost and equity method investments	4,306	(1,928
Acquisitions, net of cash acquired (Note 2)	(15,801) —
Other investing activities	—	(194
Net cash used in investing activities	(24,869	) (13,847
Cash flows from financing activities:		
Principal payments of long-term debt	(7,500	) (445,782
Proceeds from issuance of long-term debt	—	425,000
Issuance of common stock	5,705	6,213
Payment of debt issuance costs	—	(2,697
Other financing activities	(1,059	) (327
Net cash used in financing activities	(2,854	) (17,593
Effect of foreign currency exchange rates on cash and cash equivalents	(843	) 54
Net increase (decrease) in cash and cash equivalents	26,117	(15,311
Cash and cash equivalents, beginning of period	35,465	20,284
Cash and cash equivalents, end of period	\$61,582	\$4,973

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

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GREATBATCH, INC.

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY — Unaudited

(in thousands)

	Common Stock		Additional Paid-In Capital	Treasury Stock		Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
	Shares	Amount		Shares	Amount			
At January 3, 2014	24,459	\$24	\$344,915	(37)	\$(1,232)	\$183,990	\$14,358	\$542,055
Stock-based compensation	—	—	6,800	—	—	—	—	6,800
Net shares issued under stock incentive plans	500	1	8,594	(74)	(3,703)	—	—	4,892
Shares contributed to 401(k) Plan	—	—	126	95	4,215	—	—	4,341
Net income	—	—	—	—	—	41,282	—	41,282
Total other comprehensive loss	—	—	—	—	—	—	(2,308)	(2,308)
At October 3, 2014	24,959	\$25	\$360,435	(16)	\$(720)	\$225,272	\$12,050	\$597,062

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

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GREATBATCH, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – Unaudited

1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information (Accounting Standards Codification (“ASC”) 270, Interim Reporting) and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information necessary for a full presentation of financial position, results of operations, and cash flows in conformity with accounting principles generally accepted in the United States of America (“GAAP”). Operating results for interim periods are not necessarily indicative of results that may be expected for the fiscal year as a whole. In the opinion of management, the condensed consolidated financial statements reflect all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of the results of Greatbatch, Inc. and its wholly-owned subsidiary, Greatbatch Ltd. (collectively “Greatbatch” or the “Company”), for the periods presented. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, sales, expenses, and related disclosures at the date of the financial statements and during the reporting period. Actual results could differ materially from these estimates. The January 3, 2014 condensed consolidated balance sheet data was derived from audited consolidated financial statements but does not include all disclosures required by GAAP. For further information, refer to the consolidated financial statements and notes included in the Company’s Annual Report on Form 10-K for the year ended January 3, 2014. The Company utilizes a fifty-two, fifty-three week fiscal year ending on the Friday nearest December 31st. The third quarter and year-to-date periods of 2014 and 2013 each contained 13 weeks and 39 weeks, respectively, and ended on October 3, and September 27, respectively.

2. ACQUISITION

On August 12, 2014 the Company purchased all of the outstanding common stock of Centro de Construcción de Cardioestimuladores del Uruguay (“CCC”), headquartered in Montevideo, Uruguay. CCC is an active implantable neuromodulation medical device systems developer and manufacturer that produces a range of medical devices including implantable pulse generators, programmer systems, battery chargers, patient wands and leads. This acquisition allows the Company to more broadly partner with medical device companies, complements the Company’s core discrete technology offerings and enhances the Company’s medical device innovation efforts.

This transaction was accounted for under the acquisition method of accounting. Accordingly, the operating results of CCC have been included in the Company’s QiG segment from the date of acquisition. For the three and nine months ended October 3, 2014, CCC added approximately \$1.6 million to the Company’s revenue and increased the Company’s net income by \$0.4 million. The aggregate purchase price of \$19.6 million was funded with cash on hand.

The cost of the acquisition was preliminarily allocated to the assets acquired and liabilities assumed from CCC based on their fair values as of the closing date of the acquisition, with the amount exceeding the fair value of the net assets acquired being recorded as goodwill. The value assigned to certain assets and liabilities are preliminary and are subject to adjustment as additional information is obtained, including, but not limited to, the finalization of: the intangible asset valuation; net assets acquired; the working capital adjustment as defined in the purchase agreement; and pre-acquisition tax positions. The valuation is expected to be finalized in 2015. When the valuation is finalized, any changes to the preliminary valuation of assets acquired or liabilities assumed may result in material adjustments to the fair value of the intangible assets acquired, as well as goodwill.

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GREATBATCH, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – Unaudited

The following table summarizes the preliminary allocation of the CCC purchase price to the assets acquired and liabilities assumed as of the acquisition date (in thousands):

Assets acquired	
Current assets	\$9,519
Property, plant and equipment	1,106
Amortizing intangible assets	6,100
Goodwill	8,321
Total assets acquired	25,046
Liabilities assumed	
Current liabilities	3,874
Deferred income taxes	1,590
Total liabilities assumed	5,464
Net assets acquired	\$19,582

The preliminary fair values of the assets acquired were determined using one of three valuation approaches: market, income or cost. The selection of a particular method for a given asset depended on the reliability of available data and the nature of the asset, among other considerations.

The market approach estimates the value for a subject asset based on available market pricing for comparable assets. The income approach estimates the value for a subject asset based on the present value of cash flows projected to be generated by the asset. The projected cash flows were discounted at a required rate of return that reflects the relative risk of the asset and the time value of money. The projected cash flows for each asset considered multiple factors from the perspective of a marketplace participant including revenue projections from existing customers, attrition trends, technology life-cycle assumptions, marginal tax rates and expected profit margins giving consideration to historical and expected margins. The cost approach estimates the value for a subject asset based on the cost to replace the asset and reflects the estimated reproduction or replacement cost for the asset, less an allowance for loss in value due to depreciation or obsolescence, with specific consideration given to economic obsolescence if indicated. These fair value measurement approaches are based on significant unobservable inputs, including management estimates and assumptions.

Current assets and liabilities - The fair value of current assets and liabilities, excluding inventory, was assumed to approximate their carrying value as of the acquisition date due to the short-term nature of these assets and liabilities.

The fair value of in-process and finished goods inventory acquired was estimated by applying a version of the market approach called the comparable sales method. This approach estimates the fair value of the assets by calculating the potential revenue generated from selling the inventory and subtracting from it the costs related to the completion and sale of that inventory and a reasonable profit allowance. Based upon this methodology, the Company recorded the inventory acquired at fair value resulting in an increase in inventory of \$0.3 million.

Intangible assets - The purchase price was allocated to intangible assets as follows (dollars in thousands):

	Fair Value Assigned	Weighted Average Amortization Period (Years)	Weighted Average Discount Rate
Amortizing Intangible Assets			
Technology	\$1,400	10	18%

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Customer lists	4,600	10	18%
Trademarks and tradenames	100	2	18%
	6,100		

Technology - Technology consists of technical processes, unpatented technology, manufacturing know-how, trade secrets and the understanding with respect to products or processes that have been developed by CCC and that will be

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GREATBATCH, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – Unaudited

leveraged in current and future products. The fair value of technology acquired was determined utilizing the relief from royalty method, a form of the income approach, with a royalty rate of 3%. The weighted average amortization period of the technology is based upon management's estimate of the product life cycle associated with technology and patents before they will be replaced by new technologies.

Customer lists - Customer lists represent the estimated fair value of non-contractual customer relationships CCC has as of the acquisition date. The primary customers of CCC include medical device companies in various geographic locations around the world. These relationships were valued separately from goodwill at the amount that an independent third party would be willing to pay for these relationships. The fair value of customer lists was determined using the multi-period excess-earnings method, a form of the income approach. The weighted average amortization period of the existing customer base was based upon the historical customer annual attrition rate of 15%, as well as management's understanding of the industry and product life cycles.

Trademarks and tradenames – Trademarks and tradenames represent the estimated fair value of corporate and product names acquired from CCC. These tradenames were valued separately from goodwill at the amount that an independent third party would be willing to pay for use of these names. The fair value of the trademarks and tradenames was determined by utilizing the relief from royalty method, a form of the income approach, with a 0.5% royalty rate.

Goodwill - The excess of the purchase price over the fair value of net tangible and intangible assets acquired and liabilities assumed was allocated to goodwill. Various factors contributed to the establishment of goodwill, including: the value of CCC's highly trained assembled work force and management team; the incremental value that CCC's technology will bring to QiG's medical devices; and the expected revenue growth over time that is attributable to increased market penetration from future products and customers for Greatbatch Medical. The goodwill acquired in connection with the CCC acquisition was allocated to the QiG business segment and is not deductible for tax purposes.

Pro Forma Results (Unaudited)

The following unaudited pro forma information presents the consolidated results of operations of the Company and CCC as if that acquisition occurred as of the beginning of fiscal year 2013 (in thousands, except per share amounts):

	Three Months Ended		Nine Months Ended	
	October 3, 2014	September 27, 2013	October 3, 2014	September 27, 2013
Sales	\$173,413	\$171,158	\$526,631	\$497,610
Net income	14,219	11,407	42,165	27,495
Earnings per share:				
Basic	\$0.57	\$0.47	1.70	1.15
Diluted	\$0.55	\$0.45	1.63	1.10

The results prior to the acquisition date have been adjusted to include the pro forma impact of the amortization of acquired intangible assets based on the purchase price allocations and the impact of income taxes on the pro forma adjustments utilizing the applicable statutory tax rate. The unaudited pro forma consolidated basic and diluted earnings per share calculations are based on the consolidated basic and diluted weighted average shares of Greatbatch.

The unaudited pro forma results are presented for illustrative purposes only and do not reflect the realization of potential cost savings or any related integration costs. Certain cost savings may result from the acquisition; however,

there can be no assurance that these cost savings will be achieved. These pro forma results do not purport to be indicative of the results that would have been obtained in the periods presented, or to be indicative of results that may be obtained in the future.

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GREATBATCH, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – Unaudited

3. SUPPLEMENTAL CASH FLOW INFORMATION

(in thousands)	Nine Months Ended	
	October 3, 2014	September 27, 2013
Noncash investing and financing activities:		
Common stock contributed to 401(k) Plan	\$4,341	\$2,477
Property, plant and equipment purchases included in accounts payable	2,618	711
Cash paid during the period for:		
Interest	\$2,736	\$4,388
Income taxes	11,791	31,755
Acquisition of noncash assets	\$21,282	\$—
Liabilities assumed	5,464	—

4. INVENTORIES

Inventories are comprised of the following (in thousands):

	As of	
	October 3, 2014	January 3, 2014
Raw materials	\$74,718	\$67,939
Work-in-process	39,604	36,670
Finished goods	14,405	13,749
Total	\$128,727	\$118,358

5. INTANGIBLE ASSETS

Amortizing intangible assets are comprised of the following (in thousands):

	Gross Carrying Amount	Accumulated Amortization	Foreign Currency Translation	Net Carrying Amount
At October 3, 2014				
Technology and patents	\$95,776	\$(74,287)	) \$1,966	\$23,455
Customer lists	72,857	(29,705)	) 1,374	44,526
Other	4,534	(4,555))	