

MERIT MEDICAL SYSTEMS INC  
Form 10-Q  
August 06, 2010  
[Table of Contents](#)

# 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 JUNE 30, 2010.

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 Number 0-18592

**MERIT MEDICAL SYSTEMS, INC.**

(Exact name of Registrant as specified in its charter)

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Utah

(State or other jurisdiction of incorporation or organization)

87-0447695

(I.R.S. Identification No.)

1600 West Merit Parkway, South Jordan, UT, 84095

(Address of Principal Executive Offices, including Zip Code)

(801) 253-1600

(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Sections 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 has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T 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, or a non-accelerated filer. See definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

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 Rule 12b-2 of the Exchange Act). Yes  No

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

Common Stock  
Title or class

28,217,846  
Number of Shares  
Outstanding at August 3, 2010

Table of Contents

**MERIT MEDICAL SYSTEMS, INC.**

**INDEX TO FORM 10-Q**

|                                  | <b>PAGE</b>  |
|----------------------------------|--|
| <b><u>PART I.</u></b>            | <b><u>FINANCIAL INFORMATION</u></b>  |
| <u>Item 1.</u>                   | <u>Financial Statements</u>  |
|                                  | <u>Consolidated Balance Sheets as of June 30, 2010 and December 31, 2009</u> 1                           |
|                                  | <u>Consolidated Statements of Operations for the three and six months ended June 30, 2010 and 2009</u> 3 |
|                                  | <u>Consolidated Statements of Cash Flows for the six months ended June 30, 2010 and 2009</u> 4           |
|                                  | <u>Condensed Notes to Consolidated Financial Statements</u> 6  |
| <u>Item 2.</u>                   | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> 12          |
| <u>Item 3.</u>                   | <u>Quantitative and Qualitative Disclosures About Market Risk</u> 17                                     |
| <u>Item 4.</u>                   | <u>Controls and Procedures</u> 17  |
| <b><u>PART II.</u></b>           | <b><u>OTHER INFORMATION</u></b>  |
| <u>Item 1. Legal Proceedings</u> | 18   |
| <u>Item 1A. Risk Factors</u>     | 18   |
| <u>Item 6. Exhibits</u>          | 18   |
| <u>SIGNATURES</u>                | 19   |

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Table of Contents**Part I - FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****MERIT MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**

## CONSOLIDATED BALANCE SHEETS

JUNE 30, 2010 AND DECEMBER 31, 2009

(In thousands - unaudited)

|  | June 30,<br>2010 | December 31,<br>2009 |
|--|------------------|----------------------|
| <b>ASSETS</b>  |                  |                      |
| <b>CURRENT ASSETS:</b>   |                  |                      |
| Cash and cash equivalents  | \$ 4,254         | \$ 6,133             |
| Trade receivables - net of allowances of \$599 and \$541, respectively                   | 37,010           | 30,954               |
| Employee receivables   | 145              | 145                  |
| Other receivables  | 447              | 827                  |
| Inventories  | 47,219           | 47,170               |
| Prepaid expenses and other assets  | 3,047            | 1,801                |
| Deferred income tax assets   | 3,289            | 3,289                |
| Income tax refunds receivable  | 177              | 295                  |
| <b>Total current assets</b>  | <b>95,588</b>    | <b>90,614</b>        |
| <b>PROPERTY AND EQUIPMENT:</b>   |                  |                      |
| Land and land improvements   | 10,932           | 9,777                |
| Building   | 49,768           | 50,040               |
| Manufacturing equipment  | 83,997           | 77,069               |
| Furniture and fixtures   | 17,215           | 15,586               |
| Leasehold improvements   | 11,870           | 10,280               |
| Construction-in-progress   | 11,609           | 13,968               |
| <b>Total</b>   | <b>185,391</b>   | <b>176,720</b>       |
| Less accumulated depreciation  | (67,319)         | (62,074)             |
| <b>Property and equipment net</b>  | <b>118,072</b>   | <b>114,646</b>       |
| <b>OTHER ASSETS:</b>   |                  |                      |
| Other intangibles - net of accumulated amortization of \$6,782 and \$5,450, respectively | 26,958           | 26,898               |
| Goodwill   | 33,002           | 33,002               |
| Other assets   | 6,592            | 6,353                |
| <b>Total other assets</b>  | <b>66,552</b>    | <b>66,253</b>        |

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|              |    |         |    |         |
|--------------|----|---------|----|---------|
| TOTAL ASSETS | \$ | 280,212 | \$ | 271,513 |
|--------------|----|---------|----|---------|

See notes to consolidated financial statements.

(Continued)

Table of Contents**MERIT MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**

## CONSOLIDATED BALANCE SHEETS

JUNE 30, 2010 AND DECEMBER 31, 2009

(In thousands - unaudited)

|   | June 30,<br>2010  | December 31,<br>2009 |
|---|-------------------|----------------------|
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |                   |                      |
| <b>CURRENT LIABILITIES:</b>   |                   |                      |
| Trade payables  | \$ 13,456         | \$ 13,352            |
| Accrued expenses  | 14,309            | 12,196               |
| Line of credit  |                   | 7,000                |
| Advances from employees   | 645               | 212                  |
| Income taxes payable  | 2,246             | 148                  |
| Total current liabilities   | 30,656            | 32,908               |
| DEFERRED INCOME TAX LIABILITIES   | 11,068            | 11,251               |
| LIABILITIES RELATED TO UNRECOGNIZED TAX BENEFITS  | 2,945             | 2,945                |
| DEFERRED COMPENSATION PAYABLE   | 3,417             | 3,382                |
| DEFERRED CREDITS  | 1,817             | 1,874                |
| OTHER LONG-TERM OBLIGATIONS   | 263               | 344                  |
| Total liabilities   | 50,166            | 52,704               |
| <b>STOCKHOLDERS EQUITY:</b>   |                   |                      |
| Preferred stock 5,000 shares authorized as of June 30, 2010 and December 31, 2009; no shares issued                                       |                   |                      |
| Common stock no par value; 100,000 shares authorized; 28,205 and 28,181 shares issued at June 30, 2010 and December 31 2009, respectively | 64,724            | 63,690               |
| Retained earnings   | 165,427           | 155,204              |
| Accumulated other comprehensive loss  | (105)             | (85)                 |
| Total stockholders equity   | 230,046           | 218,809              |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>  | <b>\$ 280,212</b> | <b>\$ 271,513</b>    |

See notes to consolidated financial statements.

(Concluded)

Table of Contents**MERIT MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**

## CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2010 AND 2009

(In thousands, except per common share - unaudited)

|                                      | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |            |
|--------------------------------------|--------------------------------|-----------|------------------------------|------------|
|                                      | 2010                           | 2009      | 2010                         | 2009       |
| NET SALES                            | \$ 74,948                      | \$ 64,837 | \$ 142,380                   | \$ 123,208 |
| COST OF SALES                        | 42,490                         | 36,694    | 81,487                       | 70,257     |
| GROSS PROFIT                         | 32,458                         | 28,143    | 60,893                       | 52,951     |
| OPERATING EXPENSES:                  |                                |           |                              |            |
| Selling, general, and administrative | 19,939                         | 16,287    | 38,971                       | 31,116     |
| Research and development             | 3,742                          | 2,893     | 6,799                        | 4,972      |
| Total operating expenses             | 23,681                         | 19,180    | 45,770                       | 36,088     |
| INCOME FROM OPERATIONS               | 8,777                          | 8,963     | 15,123                       | 16,863     |
| OTHER INCOME (EXPENSE):              |                                |           |                              |            |
| Interest income                      | 12                             | 28        | 20                           | 150        |
| Other income (expense)               | 50                             | (6)       | 26                           | 46         |
| Other income - net                   | 62                             | 22        | 46                           | 196        |
| INCOME BEFORE INCOME TAXES           | 8,839                          | 8,985     | 15,169                       | 17,059     |
| INCOME TAX EXPENSE                   | 3,124                          | 3,144     | 4,946                        | 5,681      |
| NET INCOME                           | \$ 5,715                       | \$ 5,841  | \$ 10,223                    | \$ 11,378  |
| EARNINGS PER COMMON SHARE:           |                                |           |                              |            |
| Basic                                | \$ .20                         | \$ .21    | \$ .36                       | \$ .41     |
| Diluted                              | \$ .20                         | \$ .21    | \$ .36                       | \$ .40     |
| AVERAGE COMMON SHARES:               |                                |           |                              |            |
| Basic                                | 28,194                         | 27,924    | 28,184                       | 27,990     |
| Diluted                              | 28,729                         | 28,427    | 28,740                       | 28,487     |

See notes to consolidated financial statements.

Table of Contents**MERIT MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**

## CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE SIX MONTHS ENDED JUNE 30, 2010 AND 2009

(In thousands - unaudited)

|   | Six Months Ended<br>June 30, |           |
|---|------------------------------|-----------|
|   | 2010                         | 2009      |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                      |                              |           |
| Net income  | \$ 10,223                    | \$ 11,378 |
| Adjustments to reconcile net income to net cash provided by operating activities: |                              |           |
| Depreciation and amortization   | 6,673                        | 5,710     |
| Losses on sales and/or abandonment of property and equipment                      | 280                          | 201       |
| Write-off of certain patents and trademarks                                       | 24                           | 72        |
| Amortization of deferred credits  | (57)                         | (63)      |
| Purchase of trading investments   | (291)                        | (221)     |
| Net unrealized (gains)/losses on trading investments                              | 76                           | (185)     |
| Deferred income taxes   | (17)                         |           |
| Stock-based compensation  | 606                          | 575       |
| Tax benefit attributable to appreciation of common stock options exercised        | (49)                         | (422)     |
| Changes in operating assets and liabilities net of effects from acquisitions:     |                              |           |
| Trade receivables   | (6,618)                      | (1,662)   |
| Employee receivables  | (11)                         | (11)      |
| Other receivables   | 344                          | 344       |
| Inventories   | (49)                         | (5,725)   |
| Prepaid expenses and other assets   | (1,282)                      | (731)     |
| Income tax refund receivable  | 119                          | (41)      |
| Deposits  |                              | (18)      |
| Trade payables  | 345                          | 3,509     |
| Accrued expenses  | 1,968                        | 1,656     |
| Advances from employees   | 454                          | 210       |
| Income taxes payable  | 2,190                        | 2,212     |
| Deferred compensation payable   | 36                           | 388       |
| Other long-term assets  | (25)                         |           |
| Other long-term obligations   | (78)                         | (1)       |
| Total adjustments   | 4,638                        | 5,797     |
| Net cash provided by operating activities   | 14,861                       | 17,175    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                      |                              |           |
| Capital expenditures for:   |                              |           |
| Property and equipment  | (8,764)                      | (8,358)   |
| Patents and trademarks  | (545)                        | (782)     |
| Proceeds from the sale of property and equipment                                  | 10                           | 15        |
| Cash paid in acquisitions   | (500)                        | (35,241)  |
| Net cash used in investing activities   | (9,799)                      | (44,366)  |



See notes to consolidated financial statements.

(Continued)

Table of Contents**MERIT MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**

## CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE SIX MONTHS ENDED JUNE 30, 2010 AND 2009

(In thousands - unaudited)

|  | Six Months Ended<br>June 30, |          |
|--|------------------------------|----------|
|  | 2010                         | 2009     |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>   |                              |          |
| Proceeds from issuance of common stock   | \$ 379                       | \$ 385   |
| Additions to long-term debt  | 1,500                        | 10,000   |
| Payments on long-term debt   | (8,500)                      | (10,000) |
| Payment of taxes related to an exchange of common stock                                      |                              | (254)    |
| Common stock repurchased and retired   |                              | (2,474)  |
| Excess tax benefits from stock-based compensation  | 49                           | 422      |
| Net cash used in financing activities  | (6,572)                      | (1,921)  |
| EFFECT OF EXCHANGE RATES ON CASH   | (369)                        | (45)     |
| NET DECREASE IN CASH AND CASH EQUIVALENTS  | (1,879)                      | (29,157) |
| <b>CASH AND CASH EQUIVALENTS:</b>  |                              |          |
| Beginning of period  | 6,133                        | 34,030   |
| End of period  | \$ 4,254                     | \$ 4,873 |
| <b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</b> Cash paid during<br>the period for: |                              |          |
| Interest   | \$ 47                        | \$ 11    |
| Income taxes   | \$ 2,848                     | \$ 3,526 |
| <b>SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING AND FINANCING<br/>ACTIVITIES</b>           |                              |          |
| Property and equipment purchases in accounts payable   | \$ 1,869                     | \$ 1,576 |

During the six months ended June 30, 2009, 23,829 shares of the Company's common stock were surrendered in exchange for the Company's recording of payroll tax liabilities in the amount of approximately \$254,000, related to the exercise of stock options. The shares were valued based upon the closing price of the Company's common stock on the surrender date.

During the six months ended June 30, 2009, 21,556 shares of the Company's common stock, with a value of approximately \$230,000 were surrendered in exchange for the exercise of stock options.

See notes to consolidated financial statements.

(Concluded)

Table of Contents**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 six-month periods ended June 30, 2010 and 2009 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 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 June 30, 2010, and our results of operations and cash flows for the three and six-month periods ended June 30, 2010 and 2009. The results of operations for the three and six-month periods ended June 30, 2010 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 for the year ended December 31, 2009 filed with the Securities and Exchange Commission (the SEC ).

**2. Inventories.** Inventories are stated at the lower of cost or market. Inventories at June 30, 2010 and December 31, 2009 consisted of the following (in thousands):

|                 | June 30,<br>2010 | December 31,<br>2009 |
|-----------------|------------------|----------------------|
| Finished goods  | \$ 20,962        | \$ 24,502            |
| Work-in-process | 8,449            | 5,542                |
| Raw materials   | 17,808           | 17,126               |
| Total           | \$ 47,219        | \$ 47,170            |

**3. Reporting Comprehensive Income.** Comprehensive income for the three and six-month periods ended June 30, 2010 and 2009 consisted of net income and foreign currency translation adjustments. As of June 30, 2010 and December 31, 2009, the cumulative effect of such adjustments decreased stockholders' equity by approximately \$105,000 and approximately \$85,000, respectively. Comprehensive income for the three and six-month periods ended June 30, 2010 and 2009 has been computed as follows (in thousands):

|                              | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |           |
|------------------------------|--------------------------------|----------|------------------------------|-----------|
|                              | 2010                           | 2009     | 2010                         | 2009      |
| Net income                   | \$ 5,715                       | \$ 5,841 | \$ 10,223                    | \$ 11,378 |
| Foreign currency translation | 8                              | 62       | (20)                         | (7)       |
| Comprehensive income         | \$ 5,723                       | \$ 5,903 | \$ 10,203                    | \$ 11,371 |

Table of Contents

**4. Stock-based Compensation.** Stock-based compensation expense for the three and six-month periods ended June 30, 2010 and 2009 has been categorized as follows (in thousands):

|                                     | Three Months Ended<br>June 30, |     |      |     | Six Months Ended<br>June 30, |     |      |     |
|-------------------------------------|--------------------------------|-----|------|-----|------------------------------|-----|------|-----|
|                                     | 2010                           |     | 2009 |     | 2010                         |     | 2009 |     |
| Cost of sales                       | \$                             | 45  | \$   | 43  | \$                           | 96  | \$   | 93  |
| Research and development            |                                | 15  |      | 14  |                              | 29  |      | 27  |
| Selling, general and administrative |                                | 242 |      | 220 |                              | 481 |      | 455 |
| Stock-based compensation            | \$                             | 302 | \$   | 277 | \$                           | 606 | \$   | 575 |

The excess income tax benefit created from the exercises of stock options was \$49,000 and \$49,000 for the three and six-month periods ended June 30, 2010, respectively, when compared to \$50,000 and \$422,000 for the three and six-month periods ended June 30, 2009, respectively. As of June 30, 2010, the total remaining unrecognized compensation cost related to non-vested stock options, net of forfeitures, was approximately \$4.0 million and is expected to be recognized over a weighted average period of 3.25 years. During the six month period ended June 30, 2010, there were 100,000 stock award grants and during the six months ended June 30, 2009, there were no stock awards. 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, we used the following assumptions:

|                           | Six Months<br>Ended June 30, |      |
|---------------------------|------------------------------|------|
|                           | 2010                         | 2009 |
| Risk-free interest rate   | 2.24%                        | N/A  |
| Expected option life      | 6.0                          | N/A  |
| Expected price volatility | 41.40%                       | N/A  |

For the purpose of determining stock compensation for options, we estimate the average risk-free interest rate using the U.S. Treasury rate in effect as of the date of grant, based on the expected term of the stock option. We estimate the expected term of the stock options using the historical exercise behavior of our employees. We estimate the expected price volatility 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.

Table of Contents

**5. Shares Used in Computing Net Income Per Share.** The following table sets forth the computation of the number of shares used in calculating basic and diluted net income per share (in thousands, except per share amounts):

|  | Three Months  |        |                     | Six Months    |        |                     |
|--|---------------|--------|---------------------|---------------|--------|---------------------|
|  | Net<br>Income | Shares | Per Share<br>Amount | Net<br>Income | Shares | Per Share<br>Amount |
| Period ended June 30, 2010:  |               |        |                     |               |        |                     |
| Basic EPS  | \$ 5,715      | 28,194 | \$ 0.20             | \$ 10,223     | 28,184 | \$ 0.36             |
| Effect of dilutive stock options and warrants  |               | 535    |                     |               | 556    |                     |
| Diluted EPS  | \$ 5,715      | 28,729 | \$ 0.20             | \$ 10,223     | 28,740 | \$ 0.36             |
| Weighted-average shares under stock options excluded from the calculation of common stock equivalents as the impact was antidilutive |               |        |                     |               |        |                     |
|  |               | 1,063  |                     |               | 1,056  |                     |
| Period ended June 30, 2009:  |               |        |                     |               |        |                     |
| Basic EPS  | \$ 5,841      | 27,924 | \$ 0.21             | \$ 11,378     | 27,990 | \$ 0.41             |
| Effect of dilutive stock options and warrants  |               | 503    |                     |               | 497    |                     |
| Diluted EPS  | \$ 5,841      | 28,427 | \$ 0.21             | \$ 11,378     | 28,487 | \$ 0.40             |
| Weighted-average shares under stock options excluded from the calculation of common stock equivalents as the impact was antidilutive |               |        |                     |               |        |                     |
|  |               | 1,360  |                     |               | 1,692  |                     |

**6. Acquisitions.** On May 13, 2010, we signed a definitive merger agreement to acquire all of the outstanding shares of BioSphere Medical, Inc. ( Biosphere ) in an all cash transaction valued at approximately \$96 million, inclusive of all common equity and Series A Preferred preferences. BioSphere develops and markets embolotherapeutic products for the treatment of uterine fibroids, hypervascularized tumors and arteriovenous malformations. We anticipate that the proposed acquisition of BioSphere, if completed, will give us a platform technology applicable to multiple therapeutic areas with significant market potential while leveraging existing interventional radiology call points. Two immediate applications for the embolotherapy are uterine fibroids and primary liver cancer. On May 12, 2010, we secured a commitment for a five-year senior unsecured revolving credit facility of up to \$125 million. The commitment of the prospective lenders to provide the credit facility is subject to a number of customary conditions, including the negotiation and execution of definitive transaction documents. The proposed merger remains subject to other customary closing conditions, including the approval of BioSphere's stockholders. It is anticipated that the transaction will close during the third calendar quarter of 2010.

On February 19, 2010, we entered into a manufacturing and technology license agreement with a medical device manufacturer for certain medical products. We made an initial payment of \$250,000 in February of 2010, a second payment of \$250,000 in May of 2010 and have accrued an additional \$500,000 in accrued expenses. The additional payments are payable upon reaching certain milestones set forth in the agreement. We believe there is a reasonable likelihood that we will be required to make those payments. We have included the \$1.0 million intangible asset in license agreements and intend to amortize the asset over an estimated life of 10 years.

On June 2, 2009, we entered into an asset purchase agreement with Hatch Medical, L.L.C., a Georgia limited liability corporation ( Hatch ), to purchase the EN Snare® foreign body retrieval system. We paid \$14 million in June 2009 and an additional \$7 million on December 31, 2009. Our financial statements for the three and six-month periods ended June 30, 2009 reflect royalty income subsequent to the acquisition date of approximately \$143,000 and net income of approximately \$43,000, related to the Hatch acquisition. The purchase price was allocated as follows (in thousands):



Table of Contents

|                            |           |
|----------------------------|-----------|
| <b>Assets Acquired</b>     |           |
| <b>Intangibles</b>         |           |
| Developed technology       | \$ 8,100  |
| Customer list              | 590       |
| Non-compete                | 240       |
| Trademark                  | 650       |
| Goodwill                   | 11,420    |
| Total assets acquired      | 21,000    |
| <b>Liabilities Assumed</b> |           |
|                            | None      |
| Net assets acquired        | \$ 21,000 |

With respect to the assets we acquired from Hatch, we intend to amortize developed technology over 11 years and non-compete covenant over seven years. While U.S. trademarks can be renewed indefinitely, we currently estimate that we will generate cash flow from the acquired trademarks for a period of 15 years from the acquisition date.

On March 9, 2009, we entered into an asset purchase agreement with Alveolus, Inc., a North Carolina corporation ( Alveolus ), to purchase their non-vascular interventional stents used for esophageal, tracheobronchial, and biliary stenting procedures. We paid Alveolus \$19.1 million in March 2009. The gross amount of trade receivables we acquired from Alveolus was approximately \$1.0 million, of which \$49,000 is expected to be uncollectible. Our consolidated financial statements for the three and six-month periods ended June 30, 2009 reflect sales subsequent to the acquisition date of approximately \$1.8 million and \$2.3 million, respectively, and a net loss of approximately \$780,000 and \$1.0 million (includes approximately \$220,000 net of tax in legal and accounting costs incurred in the first quarter of 2009), respectively, related to our Alveolus acquisition. The purchase price was allocated as follows (in thousands):

|                                     |           |
|-------------------------------------|-----------|
| <b>Assets Acquired</b>              |           |
| Inventories                         | \$ 1,741  |
| Trade receivables                   | 974       |
| Other assets                        | 241       |
| Property and equipment              | 547       |
| <b>Intangibles</b>                  |           |
| Developed technology                | 5,700     |
| Trademarks                          | 1,400     |
| Customer lists                      | 1,100     |
| In-process research and development | 400       |
| Goodwill                            | 8,028     |
| Total assets acquired               | 20,131    |
| <b>Liabilities Assumed</b>          |           |
| Accounts payable                    | 467       |
| Other liabilities                   | 572       |
| Total liabilities assumed           | 1,039     |
| Net assets acquired                 | \$ 19,092 |

With respect to the assets we acquired from Alveolus, we intend to amortize the developed technology and trademarks over 15 years and customer lists on an accelerated basis over seven years. We intend to amortize the in-process research and development over 15 years, which will begin if the resulting product is successfully launched in the market. The acquired trademarks are scheduled for renewal in 4.03 years (based on a weighted-average calculation, from June 30, 2009 until the trademark renewal date). While U.S. trademarks can be renewed



indefinitely, we currently estimate that we will generate cash flow from the acquired trademarks for a period of 15 years from the acquisition date.

Table of Contents

On March 3, 2009, we paid \$500,000 to GMA Company, Ltd ( GMA ) representing the final payment due on our distribution agreement. The total amount paid to GMA under this agreement was approximately \$2.0 million and was allocated as a distribution agreement. We anticipate that the distribution agreement will be amortized over an estimated life of 11 years.

On February 19, 2009, we entered into an asset purchase and supply agreement with Biosearch Medical Products, Inc., a wholly-owned subsidiary of Hydromer, Inc., a New Jersey corporation ( Biosearch ), to purchase a bipolar coagulation probe and grafted biliary stents. We paid \$1.1 million in February 2009 and paid an additional \$500,000 in June 2009. Our consolidated financial statements for the three and six-month periods ended June 30, 2009 reflect sales subsequent to the acquisition date of approximately \$366,000 and \$499,000, respectively, and net income of approximately \$60,000 and \$90,000, respectively, related to the Biosearch acquisition. The purchase price was allocated as follows (in thousands):

|                            |    |       |
|----------------------------|----|-------|
| <b>Assets Acquired</b>     |    |       |
| Inventories                | \$ | 188   |
| Property and equipment     |    | 31    |
| <b>Intangibles</b>         |    |       |
| Developed technology       |    | 380   |
| Customer lists             |    | 660   |
| Non-compete                |    | 25    |
| Goodwill                   |    | 316   |
| Total assets acquired      |    | 1,600 |
| <b>Liabilities Assumed</b> |    | None  |
| Net assets acquired        | \$ | 1,600 |

With respect to the assets we acquired from Biosearch, we intend to amortize developed technology over 15 years, customer lists on an accelerated basis over eight years and a non-compete covenant over seven years.

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 these acquisitions is expected to be deductible for income tax purposes.

The following table summarizes our unaudited consolidated result of operations for the three and six-month periods ended June 30, 2009, as well as the unaudited pro forma consolidated results of operations as though the Hatch, Alveolus and Biosearch acquisitions had occurred on January 1, 2009:

|                            | Three Months Ended<br>June 30, 2009 |           | Six Months Ended<br>June 30, 2009 |            |
|----------------------------|-------------------------------------|-----------|-----------------------------------|------------|
|                            | As Reported                         | Pro Forma | As Reported                       | Pro Forma  |
| Sales                      | \$ 64,837                           | \$ 65,091 | \$ 123,208                        | \$ 125,660 |
| Net income                 | 5,841                               | 5,912     | 11,378                            | 11,318     |
| Earnings per common share: |                                     |           |                                   |            |

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|         |    |     |    |     |    |     |    |     |
|---------|----|-----|----|-----|----|-----|----|-----|
| Basic   | \$ | .21 | \$ | .21 | \$ | .41 | \$ | .40 |
| Diluted | \$ | .21 | \$ | .21 | \$ | .40 | \$ | .40 |

The unaudited pro forma condensed consolidated income statements are for informational purposes only and should not be considered indicative of actual results that would have been achieved if the Hatch, Alveolus and Biosearch acquisitions had been completed at the beginning of 2009, or results that may be obtained in any future period.

**7. Recent Accounting Pronouncements.** In January 2010, the Financial Accounting Standards Board ( FASB ) issued additional guidance on fair value disclosures. The new guidance clarifies two existing disclosure requirements and requires two new disclosures as follows: (1) a gross presentation of activities (purchases, sales, and settlements) within the Level 3 rollforward reconciliation, which will replace the net presentation format;

Table of Contents

and (2) detailed disclosures about the transfers in and out of Level 1 and 2 measurements. This guidance is effective for the first interim or annual reporting period beginning after December 15, 2009, except for the gross presentation of the Level 3 rollforward information, which is required for annual reporting periods beginning after December 15, 2010, and for interim reporting periods within those years. We adopted the fair value disclosure guidance on January 1, 2010, except for the gross presentation of the Level 3 rollforward information which we are not required to adopt until January 1, 2011. The adoption of this guidance did not have a material effect on our consolidated financial statements for the three and six-month periods ended June 30, 2010.

In October 2009, the FASB issued Accounting Standards Update ( ASU ) 2009-13, Revenue Recognition (Topic 605): *Multiple Deliverable Revenue Arrangements – A Consensus of the FASB Emerging Issues Task Force*. This update provides application guidance on whether multiple deliverables exist, how the deliverables should be separated and how the consideration should be allocated to one or more units of accounting. This update establishes a selling price hierarchy for determining the selling price of a deliverable. The selling price used for each deliverable will be based on vendor-specific objective evidence, if available, third-party evidence if vendor-specific objective evidence is not available, or estimated selling price if neither vendor-specific or third-party evidence is available. We will be required to apply this guidance prospectively for revenue arrangements entered into or materially modified after January 1, 2011; however, earlier application is permitted. We do not expect the adoption of this guidance to have a material effect on our consolidated financial statements.

**8. Income Taxes.** Our effective tax rate for the three months ended June 30, 2010 was 35.3%, relatively unchanged compared to 35.0% for the corresponding period of 2009. For the six months ended June 30, 2010, our effective tax rate was 32.6%, compared to 33.3% for the comparable period of 2009. The decrease in the effective tax rate for the six-month period ended June 30, 2010, when compared to the corresponding period of 2009, was primarily related to the profitability of our Irish operations which are taxed at a lower tax rate than our U.S. and other foreign operations.

**9. Fair Value Measurements.** The fair value of a financial instrument is the amount that could be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Financial assets are marked to bid prices and financial liabilities are marked to offer prices. Fair value measurements do not include transaction costs. A fair value hierarchy is used to prioritize the quality and reliability of the information used to determine fair values. Categorization within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. The fair value hierarchy is defined into the following three categories:

Level 1: Quoted market prices in active markets for identical assets or liabilities.

Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data.

Level 3: Unobservable inputs that are not corroborated by market

The following table provides our financial assets and liabilities carried at fair value measured on a recurring basis as of June 30, 2010 (in thousands):

| Description | Total Fair Value at June 30, 2010 | Quoted prices in active markets (Level 1) | Fair Value Measurements Using                 |   |
|-------------|-----------------------------------|---|---|---|
|             |                                   |   | Significant other observable inputs (Level 2) | Significant Unobservable inputs (Level 3) |

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|                                  |    |       |    |       |
|----------------------------------|----|-------|----|-------|
| Deferred compensation assets (1) | \$ | 3,559 | \$ | 3,559 |
|----------------------------------|----|-------|----|-------|

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(1) The deferred compensation investments are held in a Rabbi trust under an insurance-based deferred compensation plan. The investments of the Rabbi trust are valued based upon unit values multiplied by the number of units held. The unit value is based upon the investment's net asset value adjusted for some administrative fees.

During the six months ended June 30, 2010, we had a write-off of approximately \$24,000 related to the measurement of non-financial assets at fair value on a nonrecurring basis subsequent to their initial recognition.

The carrying amount of cash and equivalents, receivables and trade payables approximates fair value.

Table of Contents

**10. Goodwill and Intangible Assets.** There were no changes in the carrying amount of goodwill for the six months ended June 30, 2010. Intangible assets at June 30, 2010 and December 31, 2009, consisted of the following (in thousands):

|                                       | Jun 30, 2010          |                          |                     | December 31, 2009     |                          |                     |
|---------------------------------------|-----------------------|--------------------------|---------------------|-----------------------|--------------------------|---------------------|
|                                       | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Covenant not to compete               | \$ 315                | \$ (47)                  | \$ 268              | \$ 315                | \$ (25)                  | \$ 290              |
| Customer lists                        | 4,755                 | (2,725)                  | 2,030               | 4,755                 | (2,380)                  | 2,375               |
| Developed technology                  | 17,384                | (1,145)                  | 16,239              | 17,513                | (535)                    | 16,978              |
| Distribution agreement                | 2,426                 | (512)                    | 1,914               | 2,400                 | (385)                    | 2,015               |
| In-process research and development * | 400                   |                          | 400                 | 400                   |                          | 400                 |
| License agreements                    | 1,428                 | (309)                    | 1,119               | 403                   | (287)                    | 116                 |
| Patents                               | 4,227                 | (1,314)                  | 2,913               | 3,757                 | (1,214)                  | 2,543               |
| Royalty agreements                    | 267                   | (240)                    | 27                  | 267                   | (213)                    | 54                  |
| Trademark                             | 2,538                 | (490)                    | 2,048               | 2,538                 | (411)                    | 2,127               |
| <b>Total</b>                          | <b>\$ 33,740</b>      | <b>\$ (6,782)</b>        | <b>\$ 26,958</b>    | <b>\$ 32,348</b>      | <b>\$ (5,450)</b>        | <b>\$ 26,898</b>    |

\* In-process research and development was capitalized in connection with our acquisition of Alveolus. Our in-process research and development intangible is currently not subject to amortization but amortization will commence upon the related product launch.

The aggregate amortization expense for the six months ended June 30, 2010 was approximately \$1.3 million.

Estimated amortization expense for the intangible assets for the next five years consists of the following (in thousands):

|                |          |
|----------------|----------|
| Remaining 2010 | \$ 1,336 |
| 2011           | 2,387    |
| 2012           | 2,213    |
| 2013           | 2,183    |
| 2014           | 2,017    |

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

### Disclosure Regarding Forward-Looking Statements

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This Report includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act ). All statements in this Report, other than statements of historical fact, are forward-looking statements for purposes of these provisions, including any projections of earnings, revenues or other financial items, any statements of the plans and objectives of management for future operations, any statements concerning proposed new products or services, any statements regarding future economic conditions or performance, and any statements of assumptions underlying any of the foregoing. All forward-looking statements included in this Report are made as of the date hereof and are based on information available to us as of such date. We assume no obligation to update any forward-looking statement. In some cases, forward-looking statements can be identified by the use of terminology such as may, will, expects, plans, anticipates, intends, believes, estimates, potential, or continue, or the negative comparable terminology. Although we believe that the expectations reflected in the forward-looking statements contained herein are reasonable, there can be no assurance that any such expectations or any forward-looking statement will prove to be correct. Our actual results will vary, and may vary materially, from those projected or assumed in the forward-looking statements. Our financial condition and

Table of Contents

results of operations, as well as any forward-looking statements, are subject to inherent risks and uncertainties, including, unanticipated consequences of Merit's recent, proposed or future acquisitions; challenges associated with Merit's efforts to pursue new market opportunities, including opportunities in the gastroenterology and pulmonary markets; infringement of Merit's technology or the assertion that Merit's technology infringes the rights of other parties; product recalls and product liability claims; downturn of the national economy and its effect on Merit's revenues, collections and supplier relations; termination of supplier relationships, or failure of suppliers to perform; inability to successfully manage growth through acquisitions; delays in obtaining regulatory approvals, or the failure to maintain such approvals; concentration of Merit's revenues among a few products and procedures; development of new products and technology that could render Merit's products obsolete; market acceptance of new products; introduction of products in a timely fashion; price and product competition; availability of labor and materials; cost increases; and fluctuations in and obsolescence of inventory; volatility of the market price of Merit's common stock; foreign currency fluctuations; changes in key personnel; work stoppage or transportation risks; modification or limitation of governmental or private insurance reimbursement procedures; changes in health care markets related to health care reform initiatives; and other factors referred to in our press releases and reports filed with the SEC, including our Annual Report on Form 10-K for the year ended December 31, 2009. All subsequent forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. Additional factors that may have a direct bearing on our operating results are discussed in Part I, Item 1A "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2009.

**Overview**

For the quarter ended June 30, 2010, we reported record revenues of \$74.9 million, up 16% from the quarter ended June 30, 2009 of \$64.8 million. Revenues for the six months ended June 30, 2010 were a record \$142.4 million, compared with \$123.2 million for the first six months of 2009, a gain of 16%.

Gross margins were 43.3% and 42.8% of sales for the three and six-month periods ended June 30, 2010, respectively, compared to 43.4% and 43.0% of sales for the three and six-month periods ended June 30, 2009, respectively. The slight decrease in gross margins can be attributed primarily to higher average fixed overhead unit costs as the result of higher production costs and a decrease in productivity as fixed costs are shared over a decreased number of units produced and an increase in material costs, all of which were partially offset by an increase of approximately 1.0% in gross margin improvement related primarily to the launch of our En Snare® device in January 2010.

Net income for the quarter ended June 30, 2010 was \$5.7 million, or \$0.20 per share, compared to \$5.8 million, or \$0.21 per share, for the comparable quarter of 2009. Net income for the six-month period ended June 30, 2010 was \$10.2 million, down 10% to \$0.36 per share, compared to \$11.4 million, or \$0.40 per share, for the comparable period of 2009. When compared to the prior year period, net income for the three and six month periods ended June 30, 2010 was primarily affected by the cost of hiring additional sales and marketing people in the U.S. and Europe, acquisition costs of approximately \$1.1 million related to our proposed acquisition of BioSphere, increased research and development expenses for the Endotek product line and a legal settlement of approximately \$477,000.

On May 13, 2010, we signed a definitive merger agreement to acquire all of the outstanding shares of BioSphere in an all cash transaction valued at approximately \$96 million, inclusive of all common equity and Series A Preferred preferences. BioSphere develops and markets embolotherapeutic products for the treatment of uterine fibroids, hypervascularized tumors and arteriovenous malformations. We anticipate that the proposed acquisition of BioSphere will give us a platform technology applicable to multiple therapeutic areas with significant market potential while leveraging existing interventional radiology call points. Two immediate applications for the embolotherapy are uterine fibroids and primary liver cancer. On May 12, 2010, we secured a commitment for a five-year senior unsecured revolving credit facility of up to \$125 million. The commitment of the prospective lenders to provide the credit facility is subject to a number of customary conditions, including the negotiation and execution of definitive transaction documents. We anticipate that the transaction will close during the third calendar quarter of 2010.





Table of Contents**Results of Operations**

The following table sets forth certain operational data as a percentage of sales for the three and six-month periods ended June 30, 2010 and 2009:

|  | Three Months Ended<br>June 30, |        | Six Months Ended<br>June 30, |        |
|--|--------------------------------|--------|------------------------------|--------|
|  | 2010                           | 2009   | 2010                         | 2009   |
| Sales  | 100.0%                         | 100.0% | 100.0%                       | 100.0% |
| Gross profit                                 | 43.3                           | 43.4   | 42.8                         | 43.0   |
| Selling, general and administrative expenses | 26.6                           | 25.1   | 27.4                         | 25.3   |
| Research and development expenses            | 5.0                            | 4.5    | 4.8                          | 4.0    |
| Income from operations                       | 11.7                           | 13.8   | 10.6                         | 13.7   |
| Other income                                 | 0.1                            | 0.0    | 0.0                          | 0.2    |
| Net income                                   | 7.6                            | 9.0    | 7.2                          | 9.2    |

**Sales.** Sales for the three months ended June 30, 2010 increased by 16%, or approximately \$10.1 million, compared to the corresponding period of 2009. Sales for the six months ended June 30, 2010 increased by 16%, or approximately \$19.2 million, compared to the corresponding period of 2009. We report sales in five product categories. Listed below are the sales relating to these product categories for the three and six-month periods ended June 30, 2010 and 2009 (in thousands):

|                                 | % Change | Three Months Ended<br>June 30, |           | % Change | Six Months Ended<br>June 30, |            |
|---------------------------------|----------|--------------------------------|-----------|----------|------------------------------|------------|
|                                 |          | 2010                           | 2009      |          | 2010                         | 2009       |
| Stand-alone devices             | 17%      | \$ 22,981                      | \$ 19,587 | 18%      | \$ 43,747                    | \$ 37,021  |
| Custom kits and procedure trays | 8%       | 20,869                         | 19,280    | 10%      | 40,379                       | 36,677     |
| Inflation devices               | 15%      | 16,897                         | 14,707    | 7%       | 31,121                       | 28,994     |
| Catheters                       | 30%      | 11,791                         | 9,070     | 26%      | 22,251                       | 17,704     |
| Gastroenterology devices        | 10%      | 2,410                          | 2,193     | 74%      | 4,882                        | 2,812      |
| Total                           | 16%      | \$ 74,948                      | \$ 64,837 | 16%      | \$ 142,380                   | \$ 123,208 |

The sales growth of 16% for the three and six-month periods ended June 30, 2010, when compared to the comparable periods of 2009, was primarily due to stand-alone sales of the En Snare® device sales of \$1.9 million and \$4.0 million, respectively, for the three and six-month periods ended June 30, 2010. Sales were also favorably affected by increased sales of catheters (particularly our Prelude® sheath product line, cardiology diagnostic catheters and mini access catheter product line), custom kits and procedure trays, and inflation devices sold to an OEM customer.

**Gross Profit.** Gross margins were 43.3% and 42.8% of sales for the three and six-month periods ended June 30, 2010, respectively, compared to 43.4% and 43.0% of sales for the three and six-month periods ended June 30, 2009, respectively. The slight decrease in gross margins can be attributed primarily to higher average fixed overhead unit costs as the result of higher production costs, a decrease in productivity as fixed costs are shared over a decreased number of units produced and an increase in material costs, all of which were partially offset by an increase of approximately 1.0% in gross margin improvement related primarily to the launch of our En Snare® device in January 2010.

Operating Expenses. Selling, general and administrative expenses increased to 26.6% of sales for the three months ended June 30, 2010, compared with 25.1% of sales for the three months ended June 30, 2009. For the six months ended June 30, 2010, selling, general and administrative expenses increased to 27.4% compared with 25.3% of sales for the six months ended June 30, 2009. Selling, general and administrative expenses increased 22% to \$19.9 million for the three months ended June 30, 2010 from \$16.3 million for the three months ended June 30, 2009. These increased expenses were primarily attributable to acquisition costs of approximately \$1.1 million related to our proposed acquisition of BioSphere. Selling, general and administrative expenses increased 25% to \$39.0 million for the six months ended June 30, 2010 from \$31.1 million for the six months ended June 30, 2009. These expense increases primarily related to the cost of hiring additional sales and marketing people in the U.S. and Europe, acquisition costs of approximately \$1.1 million related to our proposed acquisition of BioSphere and a legal settlement of approximately \$477,000. Research and development expenses increased to 5.0% of sales for the three months ended June 30, 2010, compared with 4.5% of sales for the three months ended June 30, 2009.

Table of Contents

Research and development expenses increased to 4.8% of sales for the six months ended June 30, 2010, compared to 4.0% of sales for the six months ended June 30, 2009. Research and development expenses increased 29% to \$3.7 million for the three months ended June 30, 2010 from \$2.9 million for the three months ended June 30, 2009. For the six months ended June 30, 2010 research and development expenses increased 37% to \$6.8 million from \$5.0 million during the six months ended June 30, 2009. The increase in research and development expenses related primarily to the development of several new products for the Endotek product line.

Other Income (Expense). Other income for the second quarter of 2010 was approximately \$62,000, compared to other income of approximately \$22,000 for the comparable period in 2009. The net increase in the three month period ended June 30, 2010, when compared to the comparable period in 2009, was primarily the result of foreign exchange transaction gains. Other income for the six months ended June 30, 2010 was approximately \$46,000, compared to other income of approximately \$196,000 for the corresponding period in 2009. The net change in other income for the six-month period ended June 30, 2010, when compared to the comparable period of 2009, was primarily the result of a decrease in interest income attributable to lower average cash balances.

Income Taxes. Our effective tax rate for the three months ended June 30, 2010 was 35.3%, relatively unchanged compared to 35.0% for the corresponding period of 2009. For the six months ended June 30, 2010, our effective tax rate was 32.6%, compared to 33.3% for the comparable period in 2009. The decrease in the effective tax rate for the six-month period ended June 30, 2010, when compared to the corresponding period of 2009, was primarily related to the profitability of our Irish operations which are taxed at a lower tax rate than our U.S. and other foreign operations.

Income. During the second quarter of 2010, we reported income from operations of approximately \$8.8 million, compared to approximately \$9.0 million for the comparable period of 2009. For the six months ended June 30, 2010, we reported income from operations of \$15.1 million, a decrease of 9% from \$16.9 million for the comparable period in 2009. When compared to the corresponding period of 2010, income from operations for the six-month period ended June 30, 2009, was negatively affected by costs attributable to hiring additional sales and marketing people in the U.S. and Europe, acquisition costs of approximately \$1.1 million related to our proposed acquisition of BioSphere, increased research and development expenses for the Endotek product line and a legal settlement of approximately \$477,000. These factors contributed to a decrease in net income to \$5.7 and \$10.2 million for the three and six-month periods ended June 30, 2010, respectively, compared to net income of \$5.8 million and \$11.4 million for the same periods of 2009.

**Liquidity and Capital Resources**

Our working capital as of June 30, 2010 and December 31, 2009 was \$64.9 million and \$57.7 million, respectively. The increase in working capital was primarily the result of an increase in accounts receivable related to record quarterly sales. As of June 30, 2010, we had a current ratio of 3.1 to 1.

On May 12, 2010, we entered into a commitment letter agreement pursuant to which Wells Fargo Bank, National Association and Wells Fargo Securities, LLC committed to provide to us with a five-year senior unsecured revolving credit facility of up to \$125 million. The commitment of the prospective lenders to provide the credit facility described in the commitment letter is subject to a number of customary conditions, including the negotiation and execution of definitive transaction documents. The principal purpose of the credit facility, if obtained, is to allow us to finance, in part, the transactions contemplated by the merger agreement with BioSphere. We also intend to use the credit facility for general corporate purposes.

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On December 7, 2006, we entered into an unsecured loan agreement with Bank of America, N.A. ( Bank of America ), whereby Bank of America agreed to provide us a line of credit in the amount of \$30 million. Our outstanding borrowings on this loan as of June 30, 2010 and December 31, 2009 were \$0 and \$7.0 million, respectively. Our interest rate as of June 30, 2010 and December 31, 2009 was set at approximately 1.0%. Available borrowings under this line of credit as of June 30, 2010 and December 31, 2009 were \$30 million and \$23 million, respectively.

On December 8, 2006, we entered into an unsecured loan agreement with Zions First National Bank ( Zions ), whereby Zions agreed to provide us a line of credit in the amount of \$1 million. The loan originally expired on December 1, 2009; but was extended for an additional three years to December 1, 2012. We had \$0 outstanding and \$1.0 million available under this line of credit as of June 30, 2010 and December 31, 2009.

Table of Contents

Historically, we have incurred significant expenses in connection with new facilities, production automation, product development and the introduction of new products. During 2009, we spent a substantial amount of cash, \$46.2 million, in connection with our acquisition of certain assets and product lines. In the event we pursue and complete similar transactions or acquisitions in the future, additional funds will likely be required to meet our strategic needs, which may require us to consider raising additional funds in the debt or equity markets. We currently believe that our existing cash balances, anticipated future cash flows from operations, sales of equity and existing lines of credit and committed debt financing will be adequate to fund our current and future planned operations for the next twelve months and the foreseeable future.

**Critical Accounting Policies**

The SEC has requested that all registrants address their most critical accounting policies. The SEC has indicated that a critical accounting policy is one which is both important to the representation of the registrant's financial condition and results and requires management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. We base our estimates on past experience and on various other assumptions our management believes to be reasonable under the circumstances, the results of which form the basis for making judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results will differ, and may differ materially from these estimates under different assumptions or conditions. Additionally, changes in accounting estimates could occur in the future from period to period. Our management has discussed the development and selection of our most critical financial estimates with the audit committee of our Board of Directors. The following paragraphs identify our most critical accounting policies:

**Inventory Obsolescence Reserve.** Our management reviews on a quarterly basis inventory quantities on hand for unmarketable or slow-moving products that may expire prior to being sold. This review includes quantities on hand for both raw materials and finished goods. Based on this review, we provide a reserve for any slow-moving finished good products or raw materials that we believe will expire prior to being sold or used to produce a finished good and any products that are unmarketable. This review of inventory quantities for unmarketable or slow moving products is based on forecasted product demand prior to expiration lives.

Forecasted unit demand is derived from our historical experience of product sales and production raw material usage. If market conditions become less favorable than those projected by our management, additional inventory write-downs may be required. During the years ended December 31, 2009, 2008 and 2007, we provided on an annual basis an obsolescence reserve expense of between \$1.1 million to \$1.5 million and have written off against such reserves between \$1.2 million and \$1.3 million on an annual basis. Based on this historical trend, we believe that the amount included in our obsolescence reserve represents an accurate estimate of the unmarketable or slow moving products that may expire prior to being sold.

**Allowance for Doubtful Accounts.** A majority of our receivables are with hospitals which, over our history, have demonstrated favorable collection rates. Therefore, we have experienced relatively minimal bad debts from hospital customers. In limited circumstances, we have written off bad debts as the result of the termination of our business relationships with foreign distributors. The most significant write-offs over our history have come from U.S. packers who bundle our products in surgical trays.

We maintain allowances for doubtful accounts relating to estimated losses resulting from the inability of our customers to make required payments. The allowance is based upon historical experience and a review of individual customer balances. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

**Stock-Based Compensation.** We measure share-based compensation cost at the grant date based on the value of the award and recognize the cost as an expense over the term of the vesting period. Judgment is required in estimating the fair value of share-based awards granted and their expected forfeiture rate. If actual results differ significantly from these estimates, stock-based compensation expense and our results of operations could be materially impacted.

**Income Taxes.** Under our accounting policies, we initially recognize a tax position in our financial statements when it becomes more likely than not that the position will be sustained upon examination by the tax authorities.

Table of Contents

Such tax positions are initially and subsequently measured as the largest amount of tax positions that has a greater than 50% likelihood of being realized upon ultimate settlement with the tax authorities assuming full knowledge of the position and all relevant facts. Although we believe our provisions for unrecognized tax positions are reasonable, we can make no assurance that the final tax outcome of these matters will not be different from that which we have reflected in our income tax provisions and accruals. The tax law is subject to varied interpretations, and we have taken positions related to certain matters where the law is subject to interpretation. Such differences could have a material impact on our income tax provisions and operating results in the period(s) in which we make such determination.

**Goodwill and Intangible Assets Impairment.** We test our goodwill balances for impairment as of July 1 of each year, or whenever impairment indicators arise. We utilize several reporting units in evaluating goodwill for impairment. We assess the estimated fair value of reporting units based on discounted future cash flows. If the carrying amount of a reporting unit exceeds the fair value of the reporting unit, an impairment charge is recognized in an amount equal to the excess of the carrying amount of the reporting unit goodwill over implied fair value of that goodwill. This analysis requires significant judgments, including estimation of future cash flows and the length of time they will occur, which is based on internal forecasts, and a determination of a discount rate based on our weighted average cost of capital.

We evaluate the recoverability of intangible assets whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. This analysis requires similar significant judgments as those discussed above regarding goodwill, except that undiscounted cash flows are compared to the carrying amount of intangible assets to determine if impairment exists. All of our intangible assets are subject to amortization.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Our principal market risk relates to changes in the value of the Euro and Great Britain Pound ( GBP ) relative to the value of the U.S. Dollar. We also have a limited market risk relating to the Swedish and Danish Kroner. Our consolidated financial statements are denominated in, and our principal currency is, the U.S. Dollar. A portion of our revenues (\$7.2 million, representing approximately 9.6% of aggregate revenues), for the three months ended June 30, 2010 was attributable to sales that were denominated in foreign currencies. All other international sales were denominated in U.S. Dollars. Certain of our expenses for the quarter ended June 30, 2010 were also denominated in foreign currencies, which partially offset risks associated with fluctuations of exchanges rates between foreign currencies on the one hand, and the U.S. Dollar on the other hand. During the three months ended June 30, 2010, the exchange rate between our foreign currencies against the U.S. Dollar resulted in a decrease of our gross revenues of approximately \$411,000 and an increase of 0.12% in gross profit. This improvement in gross profits was the result of a decrease in our Irish manufacturing expenses which are primarily denominated in Euros.

On May 31, 2010, we forecasted a net exposure for June 30, 2010 representing the difference between the Euro- and GBP-denominated receivables and Euro and GBP-denominated payables of approximately 48,000 Euros 278,000 GBPs, respectively. In order to partially offset such risks, on May 31, 2010 we entered into a 30-day forward contract for Euros and GBPs. We generally enter into similar economic transactions at various times during the year to partially offset exchange rate risks we bear throughout the year. During the quarter ended June 30, 2010, we recorded a net gain of approximately \$58,000 on foreign currency transactions. We do not purchase or hold derivative financial instruments for speculative or trading purposes. The fair value of our open positions at June 30, 2010 was not material to our consolidated financial statements.

As of June 30, 2010, we had no variable rate debt. As long as we do not have variable rate debt, our interest expense would not be affected by changes in interest rates.



**ITEM 4. CONTROLS AND PROCEDURES**

**(a) Evaluation of disclosure controls and procedures**

An evaluation of the effectiveness of our disclosure controls and procedures as of June 30, 2010 was performed under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer. Based on that evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures are effective to ensure that

Table of Contents

information required to be disclosed in our reports filed or submitted under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported as specified in the SEC's rules and forms.

**(b) Changes in Internal Control Over Financial Reporting**

There was no change in our internal control over financial reporting during the quarter ended June 30, 2010 that materially affected, or that we believe is reasonably likely to materially affect, our internal control over financial reporting.

**PART II - OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

We are subject to certain legal actions which we consider routine to our business activities. As of June 30, 2010, our management concluded, after consultation with legal counsel, that the ultimate outcome of such legal matters is not likely to have a material adverse effect on our financial position, liquidity or results of operations.

**ITEM 1A. RISK FACTORS**

In addition to other information set forth in this Report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2009, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially and adversely affect our business, financial condition and/or operating results.

**ITEM 6. EXHIBITS**

| <b>Exhibit No.</b> | <b>Description</b>   |
|--------------------|--|
| 31.1               | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2               | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1               | Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2               | Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |



Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

MERIT MEDICAL SYSTEMS, INC.

REGISTRANT

Date: August 6, 2010

/s/ Fred P. Lampropoulos  
FRED P. LAMPROPOULOS  
PRESIDENT AND CHIEF EXECUTIVE OFFICER

Date: August 6, 2010

/s/ Kent W. Stanger  
KENT W. STANGER  
CHIEF FINANCIAL OFFICER