

WRIGHT MEDICAL GROUP INC

Form 10-Q

October 29, 2010

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q**

(Mark One)

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

For the quarterly period ended September 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: 000-32883

WRIGHT MEDICAL GROUP, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware

(State or Other Jurisdiction
of Incorporation or Organization)

13-4088127

(IRS Employer
Identification Number)

**5677 Airline Road
Arlington, Tennessee**

(Address of Principal Executive Offices)

38002

(Zip Code)

(901) 867-9971

(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 (§ 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.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller Reporting
Company

(Do not check if a 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

As of October 25, 2010, there were 39,190,314 shares of common stock outstanding.

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SAFE-HARBOR STATEMENT

This quarterly report contains forward-looking statements as defined under U.S. federal securities laws. These statements reflect management's current knowledge, assumptions, beliefs, estimates, and expectations and express management's current views of future performance, results, and trends and may be identified by their use of terms such as anticipate, believe, could, estimate, expect, intend, may, plan, predict, project, will, and other. Forward-looking statements are subject to a number of risks and uncertainties that could cause our actual results to materially differ from those described in the forward-looking statements. Readers should not place undue reliance on forward-looking statements. Such statements are made as of the date of this quarterly report, and we undertake no obligation to update such statements after this date.

Risks and uncertainties that could cause our actual results to materially differ from those described in forward-looking statements include those discussed in our filings with the Securities and Exchange Commission (including those described in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2009, under the heading,

Risk Factors and in Item 1A of Part II and elsewhere in this report), and the following:
the impact of our settlement of the federal investigation into our consulting arrangements with orthopaedic surgeons relating to our hip and knee products in the United States, including our compliance with the Deferred Prosecution Agreement through September 2011 and the Corporate Integrity Agreement through September 2015;

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demand for and market acceptance of our new and existing products;
recently enacted healthcare reform legislation and its future implementation, possible additional legislation, regulation and other governmental pressures in the United States or globally, which may affect pricing, reimbursement, taxation and rebate policies of government agencies and private payers or other elements of our business;
tax reform measures, tax authority examinations and associated tax risks and potential obligations;
our ability to identify business development and growth opportunities for existing or future products;
product quality or patient safety issues, leading to product recalls, withdrawals, launch delays, sanctions, seizures, litigation, or declining sales;
individual, group or class action alleging products liability claims, including an increase in the number of claims during any period;
future actions of the FDA or any other regulatory body or government authority that could delay, limit or suspend product development, manufacturing or sale or result in seizures, injunctions, monetary sanctions or criminal or civil liabilities;
our ability to enforce our patent rights or patents of third parties preventing or restricting the manufacture, sale or use of affected products or technology;
the impact of geographic and product mix on our sales;
retention of our sales representatives and independent distributors;
inventory reductions or fluctuations in buying patterns by wholesalers or distributors;
our ability to realize the anticipated benefits of restructuring initiatives; and
any impact of the commercial and credit environment on us and our customers and suppliers.

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PART I FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS (unaudited).
WRIGHT MEDICAL GROUP, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)
(unaudited)

	September 30, 2010	December 31, 2009
Assets:		
Current assets:		
Cash and cash equivalents	\$ 123,170	\$ 84,409
Marketable securities	33,512	86,819
Accounts receivable, net	98,415	101,720
Inventories	167,058	163,535
Prepaid expenses	10,924	13,122
Deferred income taxes	35,008	34,824
Other current assets	5,204	6,175
Total current assets	473,291	490,604
Property, plant and equipment, net	151,860	139,708
Goodwill	53,716	53,860
Intangible assets, net	16,735	17,727
Marketable securities	34,124	
Deferred income taxes	6,169	5,248
Other assets	7,792	7,137
Total assets	\$ 743,687	\$ 714,284
Liabilities and Stockholders Equity:		
Current liabilities:		
Accounts payable	\$ 16,872	\$ 13,978
Accrued expenses and other current liabilities	61,841	54,643
Current portion of long-term obligations	305	336
Total current liabilities	79,018	68,957
Long-term debt and capital lease obligations	200,301	200,326
Deferred income taxes	153	157
Other liabilities	4,782	4,436
Total liabilities	\$ 284,254	\$ 273,876
Commitments and contingencies (Note 10)		
Stockholders equity:		

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Common stock, \$.01 par value, authorized: 100,000,000 shares; issued and outstanding: 39,189,950 shares at September 30, 2010 and 38,668,882 shares at December 31, 2009	379	374
Additional paid-in capital	387,009	376,647
Accumulated other comprehensive income	22,592	22,906
Retained earnings	49,453	40,481
Total stockholders' equity	459,433	440,408
Total liabilities and stockholders' equity	\$ 743,687	\$ 714,284

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

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2010	2009	2010	2009
Net sales	\$ 121,708	\$ 117,742	\$ 380,686	\$ 357,580
Cost of sales ¹	37,989	35,880	118,064	110,646
Gross profit	83,719	81,862	262,622	246,934
Operating expenses:				
Selling, general and administrative ¹	64,877	63,703	209,089	196,133
Research and development ¹	8,779	8,537	28,398	26,460
Amortization of intangible assets	708	1,274	1,991	3,899
Restructuring charges (Note 9)	134	131	1,139	991
Total operating expenses	74,498	73,645	240,617	227,483
Operating income	9,221	8,217	22,005	19,451
Interest expense, net	1,532	1,435	4,550	3,974
Other expense (income), net	313	108	270	(358)
Income before income taxes	7,376	6,674	17,185	15,835
Provision for income taxes	2,726	2,522	8,213	5,939
Net income	\$ 4,650	\$ 4,152	\$ 8,972	\$ 9,896
Net income per share (Note 7):				
Basic	\$ 0.12	\$ 0.11	\$ 0.24	\$ 0.27
Diluted	\$ 0.12	\$ 0.11	\$ 0.24	\$ 0.26
Weighted-average number of shares outstanding-basic	37,935	37,431	37,748	37,331
Weighted-average number of shares outstanding-diluted	38,011	37,551	37,923	37,395

¹ These line items include the following amounts of non-cash, stock-based compensation

expense for the
periods
indicated:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2010	2009	2010	2009
Cost of sales	\$ 314	\$ 335	\$ 980	\$ 938
Selling, general and administrative	2,261	2,517	7,700	7,822
Research and development	492	480	1,500	1,440

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

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

	Nine Months Ended	
	September 30,	
	2010	2009
Operating activities:		
Net income	\$ 8,972	\$ 9,896
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	26,073	23,865
Stock-based compensation expense	10,180	10,200
Amortization of intangible assets	1,991	3,899
Amortization of deferred financing costs	777	738
Deferred income taxes	(3,470)	(2,709)
Excess tax benefit from stock-based compensation arrangements	(288)	(24)
Non-cash restructuring charges	246	
Other	1,170	(14)
Changes in assets and liabilities (net of acquisitions):		
Accounts receivable	3,384	(5,925)
Inventories	(2,736)	10,418
Prepaid expenses and other current assets	2,527	8,200
Accounts payable	2,949	(1,968)
Accrued expenses and other liabilities	8,221	(6,465)
Net cash provided by operating activities	59,996	50,111
Investing activities:		
Capital expenditures	(35,950)	(26,360)
Acquisitions of businesses	(2,072)	(5,973)
Purchase of intangible assets	(1,598)	(882)
Investment in held-to-maturity marketable securities	(4,674)	
Sales and maturities of available-for-sale marketable securities	104,049	65,192
Investment in available-for-sale marketable securities	(81,067)	(48,324)
Net cash used in investing activities	(21,312)	(16,347)
Financing activities:		
Issuance of common stock	461	231
Principal payments of bank and other financing	(968)	(107)
Financing under factoring agreements, net	5	(58)
Excess tax benefit from stock-based compensation arrangements	288	24
Net cash (used in) provided by financing activities	(214)	90
Effect of exchange rates on cash and cash equivalents	291	(485)
Net increase in cash and cash equivalents	38,761	33,369

Cash and cash equivalents, beginning of period	84,409	87,865
Cash and cash equivalents, end of period	\$ 123,170	\$ 121,234

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

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

1. Summary of Significant Accounting Policies

Basis of Presentation. The unaudited condensed consolidated interim financial statements of Wright Medical Group, Inc. have been prepared in accordance with accounting principles generally accepted in the United States (U.S.) for interim financial information and the instructions to Quarterly Report on Form 10-Q and Rule 10-01 of Regulation S-X. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the U.S. have been condensed or omitted pursuant to these rules and regulations. Accordingly, these unaudited condensed consolidated interim financial statements should be read in conjunction with our consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2009, as filed with the U.S. Securities and Exchange Commission (SEC). In the opinion of management, these unaudited condensed consolidated interim financial statements reflect all adjustments necessary for a fair presentation of our interim financial results. All such adjustments are of a normal and recurring nature. The results of operations for any interim period are not indicative of results for the full fiscal year. The accompanying unaudited condensed consolidated interim financial statements include our accounts and those of our wholly-owned domestic and international subsidiaries. Intercompany accounts and transactions have been eliminated in consolidation.

Marketable Securities. We have historically invested in treasury bills, government and agency bonds, and certificates of deposit with maturity dates of less than 12 months. Beginning in the second quarter of 2010, we also invested in marketable securities with maturity dates greater than 12 months. Our investments in these marketable securities are classified as available-for-sale securities in accordance with Financial Accounting Standards Board (FASB) Accounting Standard Codification (ASC) Topic 320, *Investments – Debt and Equity Securities*. These securities are carried at their fair value, and all unrealized gains and losses are recorded within other comprehensive income. In the third quarter of 2010, we invested in a bank deposit with a maturity date of 12 months. This investment, which is classified as held-to-maturity, is carried at its amortized cost. Marketable securities are classified as short-term for those expected to mature or be sold within 12 months and the remaining portion is classified as long-term. The cost of investment securities sold is determined by the specific identification method. The following tables present a summary of our marketable securities (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
At September 30, 2010				
Available-for-sale marketable securities				
Municipal debt securities	\$ 903	\$ 3	\$	\$ 906
U.S. agency debt securities	41,356	28	(2)	41,382
Certificates of deposits	1,363			1,363
Corporate debt securities	3,199	13		3,212
U.S. government debt securities	16,034	26		16,060
Total available-for-sale marketable securities	\$ 62,855	\$ 70	\$ (2)	\$ 62,923
Held-to-maturity time deposits	\$ 4,713	\$	\$	\$ 4,713
Total marketable securities	\$ 67,568	\$ 70	\$ (2)	\$ 67,636

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	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
At December 31, 2009				
Available-for-sale marketable securities				
U.S. agency debt securities	\$ 69,819	\$ 11	\$ (50)	\$ 69,780
Certificates of deposits	1,435		(5)	1,430
U.S. government debt securities	15,604	10	(5)	15,609
Total available-for-sale marketable securities	\$ 86,858	\$ 21	\$ (60)	\$ 86,819
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WRIGHT MEDICAL GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(UNAUDITED)

The maturities of available-for-sale and held-to-maturity debt securities at September 30, 2010 are as follows:

	Available-for-Sale		Held-to-maturity	
	Cost Basis	Fair Value	Cost Basis	Fair Value
Due in one year or less	\$ 28,786	\$ 28,799	\$ 4,713	\$ 4,713
Due after one year through two years	26,569	26,620		
Due after two years	7,500	7,504		
	\$ 62,855	\$ 62,923	\$ 4,713	\$ 4,713

Fair Value of Financial Instruments. The carrying values of cash and cash equivalents, accounts receivable, and accounts payable approximate the fair values of these financial instruments as of September 30, 2010 and December 31, 2009 due to their short maturities.

Effective January 1, 2008, we adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* (SFAS 157), for financial assets and liabilities measured at fair value on a recurring basis. Effective January 1, 2009, we adopted the provisions of SFAS 157 for nonfinancial assets and liabilities measured at fair value on a recurring basis. SFAS 157 applies to all financial and nonfinancial assets and liabilities that are being measured and reported on a fair value basis, establishes a framework for measuring the fair value of assets and liabilities, and expands disclosures about fair value measurements. The adoption of SFAS 157 had no impact to our condensed consolidated interim financial statements. Effective July 1, 2009, this standard was incorporated into FASB ASC Topic 820, *Fair Value Measurements and Disclosures* (FASB ASC 820). FASB ASC 820-10-50 requires fair value measurements be classified and disclosed in one of the following three categories:

Level 1: Financial instruments with unadjusted, quoted prices listed on active market exchanges.

Level 2: Financial instruments determined using prices for recently traded financial instruments with similar underlying terms as well as directly or indirectly observable inputs, such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3: Financial instruments that are not actively traded on a market exchange. This category includes situations where there is little, if any, market activity for the financial instrument. The prices are determined using significant unobservable inputs or valuation techniques.

As of September 30, 2010 and December 31, 2009, we had current marketable securities totaling \$33.5 million and \$86.8 million, respectively, consisting of investments in treasury bills, government and agency bonds, and certificates of deposits, all of which are valued at fair value using a market approach. In addition, we had noncurrent marketable securities totaling \$34.1 million as of September 30, 2010, consisting of investments in government, agency, and corporate bonds, all of which are valued at fair value using a market approach.

The following table summarizes the valuation of our financial instruments (in thousands):

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

	Total	Quoted Prices in Active Markets (Level 1)	Prices with Other Observable Inputs (Level 2)	Prices with Unobservable Inputs (Level 3)
At September 30, 2010				
Assets				
Cash and cash equivalents	\$ 123,170	\$ 123,170	\$	\$
Available-for-sale marketable securities				
Municipal debt securities	\$ 906	\$ 906	\$	\$
U.S. agency debt securities	41,382	41,382		
Certificates of deposits	1,363		1,363	
Corporate debt securities	3,212	3,212		
U.S. government debt securities	16,060	16,060		
Total available-for-sale marketable securities	62,923	61,560	1,363	
Held-to-maturity time deposits	4,713		4,713	
	\$ 190,806	\$ 184,730	\$ 6,076	\$
Liabilities				
Convertible Senior Notes	178,000	178,000		
	\$ 178,000	\$ 178,000	\$	\$
At December 31, 2009				
Assets				
Cash and cash equivalents	\$ 84,409	\$ 84,409	\$	\$
Available-for-sale marketable securities				
U.S. agency debt securities	\$ 69,780	\$ 69,780	\$	\$
Certificates of deposits	1,430		1,430	

