STERIS CORP
Form 10-Q
August 07, 2007
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2007

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 1-14643

STERIS Corporation

(Exact name of registrant as specified in its charter)

Ohio	**34-1482024**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**
5960 Heisley Road,	**44060-1834**

Mentor, Ohio
(Address of principal executive offices) **(Zip code)**

440-354-2600

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer x Accelerated Filer ¨ Non-Accelerated Filer ¨

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

The number of common shares outstanding as of July 31, 2007: 64,817,144

Table of Contents

STERIS Corporation

Form 10-Q

Index

Table of Contents

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

STERIS CORPORATION

CONSOLIDATED BALANCE SHEETS

(in thousands)

	June 30, 2007 (Unaudited)	March 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	$ 57,946	$ 52,296
Accounts receivable (net of allowances of $8,513 and $9,911, respectively)	207,650	251,207
Inventories, net	153,213	131,997
Current portion of deferred income taxes, net	14,838	14,560
Prepaid expenses and other current assets	33,022	34,660
Total current assets	466,669	484,720
Property, plant, and equipment, net	386,313	388,899
Goodwill and intangibles, net	331,993	332,947
Other assets	2,901	2,604
Total assets	$ 1,187,876	$ 1,209,170
Liabilities and shareholders equity		
Current liabilities:		
Current portion of long-term indebtedness	$ 777	$ 777
Accounts payable	64,162	76,184
Accrued income taxes	13,978	18,761
Accrued payroll and other related liabilities	42,905	59,003
Accrued expenses and other	62,273	62,674
Total current liabilities	184,095	217,399
Long-term indebtedness	109,780	100,800
Deferred income taxes, net	24,025	17,826
Other liabilities	97,321	98,853
Total liabilities	415,221	434,878
Serial preferred shares, without par value; 3,000 shares authorized; no shares issued or outstanding		
Common shares, without par value; 300,000 shares authorized; 70,040 shares issued; 64,741 and 64,982 shares outstanding, respectively	92,852	102,466
Retained earnings	668,778	667,267
Accumulated other comprehensive income (loss)	11,025	4,559
Total shareholders equity	772,655	774,292
Total liabilities and shareholders equity	$ 1,187,876	$ 1,209,170

See notes to consolidated financial statements.

Table of Contents

STERIS CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share amounts)

(Unaudited)

	Three Months Ended June 30, 2007	2006
Revenues:		
Product	$ 172,369	$ 165,759
Service	108,575	99,308
Total revenues	280,944	265,067
Cost of revenues:		
Product	101,875	95,293
Service	60,357	56,399
Total cost of revenues	162,232	151,692
Gross profit	118,712	113,375
Operating expenses:		
Selling, general, and administrative	86,495	78,414
Research and development	9,259	8,395
Restructuring expenses	1,391	1,105
Total operating expenses	97,145	87,914
Income from continuing operations	21,567	25,461
Non-operating expenses, net:		
Interest expense	1,235	1,769
Interest and miscellaneous income	(462)	(679)
Total non-operating expenses, net	773	1,090
Income from continuing operations before income tax expense	20,794	24,371
Income tax expense	7,591	10,314
Net income from continuing operations	13,203	14,057
Discontinued operations:		
Gain on the sale of discontinued operations, net of tax		627
Net income	$ 13,203	$ 14,684
Basic earnings per common share:		
Income from continuing operations	$ 0.20	$ 0.21
Income from discontinued operations	$	$ 0.01
Net income	$ 0.20	$ 0.22
Diluted earnings per common share:		

Income from continuing operations	$	0.20	$	0.21
Income from discontinued operations	$		$	0.01
Net income	$	0.20	$	0.22
Cash dividends declared per common share outstanding	$	0.05	$	0.04

See notes to consolidated financial statements.

Table of Contents

STERIS CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	Three Months Ended June 30, 2007	2006
Operating activities:		
Net income	$ 13,203	$ 14,684
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation, depletion, and amortization	15,582	14,884
Deferred income taxes	(2,705)	(7,159)
Share-based compensation	1,615	2,092
Loss on the disposal of property, plant, equipment, and intangibles, net	565	
Gain on the sale of discontinued operations, net of tax		(627)
Other items	(365)	134
Changes in operating assets and liabilities, excluding the effects of business acquisitions:		
Accounts receivable, net	45,106	40,438
Inventories, net	(19,380)	(20,280)
Other current assets	1,685	(18,759)
Accounts payable	(12,422)	(19,393)
Accruals and other, net	(23,458)	(12,691)
Net cash provided by (used in) operating activities	19,426	(6,677)
Investing activities:		
Purchases of property, plant, equipment, and intangibles, net	(9,691)	(12,415)
Proceeds from the sale of property, plant, equipment, and intangibles	22	
Proceeds from the sale of discontinued operations		2,927
Net cash used in investing activities	(9,669)	(9,488)
Financing activities:		
Proceeds under credit facilities, net	8,980	73,660
Payments on long-term obligations and capital leases, net		(212)
Repurchases of common shares	(21,235)	(50,134)
Cash dividends paid to common shareholders	(3,259)	(2,679)
Stock option and other equity transactions, net	8,096	195
Tax benefit from stock options exercised	2,067	163
Net cash (used in) provided by financing activities	(5,351)	20,993
Effect of exchange rate changes on cash and cash equivalents	1,244	2,002
Increase in cash and cash equivalents	5,650	6,830
Cash and cash equivalents at beginning of period	52,296	72,732
Cash and cash equivalents at end of period	$ 57,946	$ 79,562

See notes to consolidated financial statements.

Table of Contents

STERIS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

(dollars in thousands, except per share amounts)

1. Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

STERIS Corporation, an Ohio corporation, develops, manufactures and markets infection prevention, contamination control, microbial reduction, and surgical and critical care support products and services for healthcare, pharmaceutical, scientific, research, industrial, and governmental customers throughout the world. As used in this Quarterly Report, STERIS Corporation and its subsidiaries together are called STERIS, the Company, we, us, or our, unless otherwise noted.

We operate in three business segments: Healthcare, Life Sciences, and STERIS Isomedix Services (Isomedix). We describe our business segments in note 11 to our consolidated financial statements titled, Business Segment Information. Our fiscal year ends on March 31. References in this Quarterly Report to a particular year or year-end mean our fiscal year. The significant accounting policies applied in preparing the accompanying consolidated financial statements of the Company are summarized below:

Interim Financial Statements

We prepared the accompanying unaudited consolidated financial statements of the Company according to accounting principles generally accepted in the United States (U.S. GAAP) for interim financial information and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. This means that they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. Our interim consolidated financial statements contain all material adjustments (including normal recurring accruals and adjustments) management believes are necessary to fairly state our financial condition, results of operations, and cash flows for the periods presented.

These interim consolidated financial statements should be read together with the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended March 31, 2007, filed with the Securities and Exchange Commission (SEC) on May 30, 2007. The Consolidated Balance Sheet at March 31, 2007 was derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements.

Principles of Consolidation

We use the consolidation method to report our investment in our subsidiaries. Consolidation means that we combine the accounts of our wholly-owned subsidiaries with our accounts. Therefore, the accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. We eliminate inter-company accounts and transactions when we consolidate these accounts.

Use of Estimates

We make certain estimates and assumptions when preparing financial statements according to U.S. GAAP that affect the reported amounts of assets and liabilities at the financial statement dates and the reported amounts of revenues and expenses during the periods presented. These estimates and assumptions involve judgments with respect to many factors that are difficult to predict and are beyond our control. Actual results could be materially different from these estimates. We revise the estimates and assumptions as new information becomes available. This means that operating results for the three-month period ended June 30, 2007 are not necessarily indicative of results that may be expected for future quarters or for the full fiscal year ending March 31, 2008.

STERIS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

(dollars in thousands, except per share amounts)

Recently Adopted Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 (FIN No. 48), Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109. This interpretation clarifies the recognition threshold and measurement attribute for financial statement recognition and measurement of tax positions taken or expected to be taken on a tax return. Under FIN No. 48, the economic benefit associated with a tax position is only recognized if it is more likely than not that the tax position will be sustained. After this threshold is met, a tax position is reported at the largest amount of benefit that is more likely than not to be ultimately sustained. FIN No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN No. 48 requires the cumulative effect of adoption to be recorded as an adjustment to the opening balance of retained earnings. We adopted FIN No. 48 effective April 1, 2007, as required. Prior to April 1, 2007, we regularly assessed our positions with respect to tax exposures and recorded liabilities for uncertain income tax positions according to Statement of Financial Accounting Standards No. 5 (SFAS No. 5), Accounting for Contingencies. We describe the impact of adopting FIN No. 48 further in note 8 to our consolidated financial statements titled, Income Tax Expense.

New Accounting Pronouncements

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159 (SFAS No. 159), The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of SFAS 115, which permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. Unrealized gains and losses arising after adoption are reported in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. We are currently evaluating the impact of adopting SFAS No. 159 on our consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157 (SFAS No. 157), Fair Value Measurements. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 does not require new fair value measurements, rather it applies under existing accounting pronouncements that require or permit fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. We are currently evaluating the impact of adopting SFAS No. 157 on our consolidated financial statements.

Significant Accounting Policies

A detailed description of our significant and critical accounting policies, estimates, and assumptions is included in our Annual Report on Form 10-K for the year ended March 31, 2007, filed with the SEC on May 30, 2007. Our significant and critical accounting policies, estimates, and assumptions have not changed materially from March 31, 2007, other than the adoption of FIN No. 48 as described above.

2. Restructuring

We recognize restructuring expenses as incurred as required under the provisions of Statement of Financial Accounting Standards No. 146 (SFAS No. 146), Accounting for Costs Associated with Exit or Disposal Activities. In addition, we assessed the property, plant and equipment associated with the related facilities for impairment under Statement of Financial Accounting Standards No. 144 (SFAS No. 144), Accounting for the Impairment or Disposal of Long-Lived Assets. Asset impairment and accelerated depreciation expenses

Table of Contents

STERIS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

(dollars in thousands, except per share amounts)

primarily relate to an adjustment in the carrying value of the related facilities to their estimated fair value. In addition, the remaining useful lives of other property, plant and equipment associated with the related operations were reevaluated based on the respective restructuring plan, resulting in the acceleration of depreciation and amortization of certain assets.

Fiscal 2006 Restructuring Plan

During the three months ended June 30, 2007 and 2006, we recorded $1,391 and $1,105 in restructuring expenses, respectively, primarily related to the previously announced transfer of the Erie, Pennsylvania manufacturing operations to Monterrey, Mexico (the Fiscal 2006 Restructuring Plan), which is intended to improve our cost structure. Additional information regarding the Fiscal 2006 Restructuring Plan is included in our Annual Report on Form 10-K for the year ended March 31, 2007, filed with the SEC on May 30, 2007.

The costs incurred during the first quarter of fiscal 2008 and fiscal 2007 are associated with our Healthcare business segment. Since the inception of the Fiscal 2006 Restructuring Plan, we have incurred restructuring expenses of $31,580, with restructuring expenses of $31,166 and $414 related to the Healthcare and Life Sciences segments, respectively, primarily related to the transfer of manufacturing operations to Monterrey, Mexico.

We anticipate incurring approximately an additional $3,000 in restructuring expenses during fiscal 2008 in connection with the transfer of the manufacturing operations to Mexico. Restructuring expenses to be incurred include compensation and benefits, severance, accelerated depreciation and other expenses.

The following tables summarize our total restructuring expenses for the first quarter of fiscal 2008 and fiscal 2007:

	Three Months Ended June 30,	
Fiscal 2006 Restructuring Plan	**2007**	**2006**
Asset impairment and accelerated depreciation	$ 1,059	$ 705
Severance, payroll and other related costs	332	390
Other		10
Total restructuring charges	$ 1,391	$ 1,105

Liabilities related to the Fiscal 2006 Restructuring Plan activities are recorded as current liabilities on the accompanying Consolidated Balance Sheets within Accrued expenses and other. The following table summarizes our liabilities related to these restructuring activities:

	Fiscal 2006 Restructuring Plan			
	March 31,	**Fiscal 2008**		**June 30,**
	2007	**Provision**	**Payments**	**2007**
Severance and termination benefits	$ 1,799	$ 332	$ (209)	$ 1,922
Lease termination obligation	157	(13)	(144)	
Total	$ 1,956	$ 319	$	