

MASIMO CORP
Form 10-Q
May 01, 2014
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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 March 29, 2014

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 001-33642

Masimo Corporation
(Exact Name of Registrant as Specified in its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	33-0368882 (I.R.S. Employer Identification Number)
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40 Parker Irvine, California (Address of Principal Executive Offices) (949) 297-7000 (Registrant's Telephone Number, Including Area Code)	92618 (Zip Code)
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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 (Do not check if a smaller reporting company) 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

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

Class	Number of Shares Outstanding as of March 29, 2014
Common stock, \$0.001 par value	56,737,132

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

MASIMO CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited) (in thousands, except par values)

	March 29, 2014	December 28, 2013
ASSETS		
Current assets		
Cash and cash equivalents	\$117,529	\$95,466
Accounts receivable, net of allowance for doubtful accounts of \$1,868 and \$1,833 at March 29, 2014 and December 28, 2013, respectively	74,065	76,759
Royalties receivable	7,500	7,300
Inventories	55,538	56,813
Prepaid expenses	10,437	9,243
Prepaid income taxes	908	3,740
Deferred tax assets	16,718	19,636
Other current assets	3,986	2,841
Total current assets	286,681	271,798
Deferred cost of goods sold	64,401	61,714
Property and equipment, net	25,486	24,866
Intangible assets, net	28,169	28,104
Goodwill	22,847	22,793
Deferred tax assets	22,552	22,565
Other assets	8,517	6,822
Total assets	\$458,653	\$438,662
LIABILITIES AND EQUITY		
Current liabilities		
Accounts payable	\$33,685	\$28,004
Accrued compensation	22,487	29,486
Accrued liabilities	16,448	23,028
Income taxes payable	2,533	2,406
Deferred revenue	21,680	20,755
Current portion of capital lease obligations	102	111
Total current liabilities	96,935	103,790
Deferred revenue	569	566
Capital lease obligations, less current portion	156	225
Other liabilities	7,550	7,680
Total liabilities	105,210	112,261
Commitments and contingencies		
Equity		
Masimo Corporation stockholders' equity:		
Preferred stock, \$0.001 par value; 5,000 shares authorized; 0 shares issued and outstanding at March 29, 2014 and December 28, 2013		—
Common stock, \$0.001 par value; 100,000 shares authorized; 56,737 and 56,623 shares outstanding at March 29, 2014 and December 28, 2013, respectively	57	57
Treasury stock, 4,156 and 4,156 shares at March 29, 2014 and December 28, 2013, respectively	(83,454) (83,454)
Additional paid-in capital	277,702	273,129

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Accumulated other comprehensive income	4,014	3,995	
Retained earnings	155,374	132,742	
Total Masimo Corporation stockholders' equity	353,693	326,469	
Noncontrolling interest	(250) (68)
Total equity	353,443	326,401	
Total liabilities and equity	\$458,653	\$438,662	

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

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MASIMO CORPORATION
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 (unaudited) (in thousands, except per share amounts)

	Three Months Ended	
	March 29, 2014	March 30, 2013
Revenue:		
Product	\$132,232	\$128,635
Royalty	7,582	7,307
Total revenue	139,814	135,942
Cost of goods sold	47,513	46,361
Gross profit	92,301	89,581
Operating expenses:		
Selling, general and administrative	56,122	52,273
Research and development	13,996	14,167
Litigation award and defense costs	(8,010)) —
Total operating expenses	62,108	66,440
Operating income	30,193	23,141
Non-operating income (expense)	200	(2,326)
Income before provision for income taxes	30,393	20,815
Provision for income taxes	7,902	4,413
Net income including noncontrolling interest	22,491	16,402
Net loss attributable to the noncontrolling interest	141	26
Net income attributable to Masimo Corporation stockholders	22,632	16,428
Other comprehensive income, net of tax:		
Foreign currency translation adjustments	19	153
Comprehensive income attributable to Masimo Corporation stockholders	\$22,651	\$16,581
Net income per share attributable to Masimo Corporation stockholders:		
Basic	\$0.40	\$0.29
Diluted	\$0.39	\$0.28
Weighted average shares used in per share calculations:		
Basic	56,705	57,240
Diluted	58,047	58,011

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

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MASIMO CORPORATION
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (unaudited) (in thousands)

	Three Months Ended		
	March 29, 2014	March 30, 2013	
Cash flows from operating activities:			
Net income including noncontrolling interest	\$22,491	\$16,402	
Adjustments to reconcile net income including noncontrolling interest to net cash provided by operating activities:			
Depreciation and amortization	3,043	2,783	
Share-based compensation	2,601	3,413	
Loss on disposal of property and equipment	2	78	
Provision for doubtful accounts	232	142	
Provision for deferred income taxes	2,926	—	
Income tax benefit from exercise of stock options granted prior to January 1, 2006	24	12	
Excess tax (benefit) deficit from share-based compensation arrangements	(31) 164	
Changes in operating assets and liabilities:			
(Increase) decrease in accounts receivable	2,469	(72)
Increase in royalties receivable	(200) (70)
(Increase) decrease in inventories	1,288	(1,109)
Increase in deferred cost of goods sold	(2,687) (2,741)
Increase in prepaid expenses	(1,186) (425)
Decrease in prepaid income taxes	2,832	1,492	
(Increase) decrease in other assets	(2,831) 1,128	
Increase in accounts payable	5,676	3,874	
Decrease in accrued compensation	(6,996) (3,405)
Increase (decrease) in accrued liabilities	(6,587) 341	
Increase in income taxes payable	156	1,779	
Increase in deferred revenue	929	1,102	
Increase (decrease) in other liabilities	(130) 213	
Net cash provided by operating activities	24,021	25,101	
Cash flows from investing activities:			
Purchases of property and equipment	(2,840) (1,839)
Increase in intangible assets	(886) (1,107)
Net cash used in investing activities	(3,726) (2,946)
Cash flows from financing activities:			
Repayments of capital lease obligations	(77) (84)
Proceeds from issuance of common stock	1,918	463	
Excess tax benefit (deficit) from share-based compensation arrangements	31	(164)
Repurchases of common stock	—	(12,431)
Repurchases of equity by noncontrolling interest	(42) —	
Net cash provided by (used in) financing activities	1,830	(12,216)
Effect of foreign currency exchange rates on cash	(62) 82	
Net increase in cash and cash equivalents	22,063	10,021	
Cash and cash equivalents at beginning of period	95,466	71,554	
Cash and cash equivalents at end of period	\$117,529	\$81,575	

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

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MASIMO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Description of the Company

Masimo Corporation (Masimo or the Company) is a global medical technology company that develops, manufactures and markets noninvasive patient monitoring products. The Company's mission is to improve patient outcomes and reduce cost of care by taking noninvasive monitoring to new sites and applications. The Company invented Masimo Signal Extraction Technology, or Masimo SET[®], which provides the capabilities of Measure-Through Motion and Low Perfusion pulse oximetry to address the primary limitations of conventional pulse oximetry. The Company has also developed Masimo rainbow[®] SET products which monitor multiple blood measurements, including oxygen content, carboxyhemoglobin, methemoglobin and hemoglobin. Additional rainbow[®] SET measurements that assist clinicians are PVI[®], RRa[®], SpfO₂[™], Halo Index[™] and In Vivo Adjustment.[™] The Company develops, manufactures and markets a family of patient monitoring solutions which incorporate a monitor or circuit board and sensors, including proprietary single-patient use, reusable and resposable sensors, and cables. The Company sells to hospitals and the alternate care market through its direct sales force and distributors, and markets its circuit boards containing the Company's proprietary algorithm and software architecture to original equipment manufacturer (OEM) partners.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP), have been condensed or omitted pursuant to such rules and regulations. The condensed consolidated financial statements have been prepared on the same basis as the annual financial statements and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments, necessary to present fairly the Company's condensed consolidated financial statements. The condensed consolidated balance sheet as of December 28, 2013 was derived from the Company's audited consolidated financial statements at that date. The accompanying condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes contained in the Company's Annual Report on Form 10-K for the fiscal year ended December 28, 2013, filed with the SEC on February 14, 2014. The results for the three months ended March 29, 2014 are not necessarily indicative of the results to be expected for the fiscal year ending January 3, 2015 or for any other interim period or for any future year.

Principles of Consolidation

The condensed consolidated financial statements include the accounts of the Company, its wholly-owned subsidiaries and the variable interest entity, or VIE, of which the Company is the primary beneficiary. All intercompany accounts and transactions have been eliminated in consolidation. In accordance with GAAP, current authoritative guidance is applied when determining whether an entity is subject to consolidation.

Fiscal Periods

The Company follows a 52-53 week fiscal year that ends on the Saturday closest to December 31. A 52 week year includes four quarters of 13 fiscal weeks while a 53 week fiscal year includes three 13 fiscal week quarters and one 14 fiscal week quarter. The last 53 week fiscal year was fiscal year 2008. Fiscal year 2014 is a 53 week fiscal year. All references to years in these notes to condensed consolidated financial statements are fiscal years unless otherwise noted.

Use of Estimates

The Company prepares its financial statements in conformity with GAAP, which requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Significant estimates include: determination of accounts receivable allowances, inventory reserves, warranty reserves, rebate reserves, valuation of the Company's stock options, goodwill valuation, deferred taxes and

any associated valuation allowances, distributor channel inventory, royalty revenues, deferred revenue, uncertain income tax positions, property taxes, litigation costs and related accruals. Actual results could differ from such estimates.

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MASIMO CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(unaudited)

Reclassifications

Certain amounts in the condensed consolidated financial statements for prior periods have been reclassified to conform to current period presentation.

Fair Value Measurements

Authoritative guidance describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value:

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

Level 2—Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Pursuant to current authoritative guidance, entities are allowed an irrevocable option to elect fair value for the initial and subsequent measurement for specified financial assets and liabilities on a contract-by-contract basis. The Company did not elect the fair value option under this guidance as to specific assets or liabilities. There were no transfers between Level 1, Level 2 and Level 3 inputs during the three months ended March 29, 2014. The Company carries cash and cash equivalents at cost, which approximates fair value. As of March 29, 2014 and December 28, 2013, the Company did not have any short-term investments.

The following tables represent the Company's fair value hierarchy for its financial assets (in thousands):

	Fair Value Measurement as of			
	March 29, 2014 using:			
	Level 1	Level 2	Level 3	Total
Assets:				
U.S. Treasuries	\$36,998	\$—	\$—	\$36,998
Money Market funds	1,792	—	—	1,792
Total	\$38,790	\$—	\$—	\$38,790
	Fair Value Measurement as of			
	December 28, 2013 using:			
	Level 1	Level 2	Level 3	Total
Assets:				
U.S. Treasuries	\$25,997	\$—	\$—	\$25,997
Money Market funds	1,793	—	—	1,793
Total	\$27,790	\$—	\$—	\$27,790

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable consist of trade receivables recorded upon recognition of revenue for product revenues, reduced by reserves for estimated bad debts and returns. Trade accounts receivable are recorded at the invoiced amount and do not bear interest. Credit is extended based on evaluation of the customer's financial condition. Collateral is not required. The allowance for doubtful accounts is determined based on historical write-off experience, current customer information and other relevant factors, including specific identification of past due accounts, based on the age of the receivable in excess of the contemplated or contractual due date. Accounts are charged off against the allowance when the Company believes they are uncollectible.

Intangible Assets

Costs to renew intangibles are capitalized and amortized over the remaining useful life of the intangible. As of March 29, 2014, the weighted average number of years until the next renewal is one year for patents and six years for trademarks.

The Company's policy is to renew its patents and trademarks. The Company continually evaluates the amortization period and carrying basis of patents and trademarks to determine whether any events or circumstances warrant a revised estimated useful life or reduction in value. Capitalized application costs are charged to operations when it is determined that the patent or trademark will not be obtained or is abandoned.

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MASIMO CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(unaudited)

Impairment of Goodwill and Intangible assets

Goodwill is recorded as the difference, if any, between the aggregate consideration p