

MERIT MEDICAL SYSTEMS INC  
Form 10-Q  
November 08, 2007

## 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 SEPTEMBER 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 **0-18592**

## MERIT MEDICAL SYSTEMS, INC.

(Exact Name of Registrant as Specified in its Charter)

**Utah**  
(State or other jurisdiction of incorporation  
or organization)

**87-0447695**  
(I.R.S. Employer Identification No.)

**1600 West Merit Parkway, South Jordan, UT, 84095**

(Address of Principal Executive Offices)

**(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 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

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).

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Yes  No

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

**Common Stock**  
Title or class

27,305,753  
Number of Shares  
Outstanding at November 5, 2007

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**MERIT MEDICAL SYSTEMS, INC.**

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## PART I - FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## MERIT MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

SEPTEMBER 30, 2007 AND DECEMBER 31, 2006

(In Thousands - Unaudited)

	September 30, 2007	December 31, 2006
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 12,199	\$ 9,838
Trade receivables - less allowances of \$530 and \$560, respectively	24,844	25,745
Employee receivables	119	194
Other receivables	882	192
Inventories	36,794	38,562
Prepaid expenses and other assets	1,463	1,031
Deferred income tax assets	3	2
Income tax refunds receivable	105	82
<b>Total current assets</b>	<b>76,409</b>	<b>75,646</b>
<b>PROPERTY AND EQUIPMENT:</b>		
Land and land improvements	8,107	7,935
Building	43,111	43,111
Manufacturing equipment	61,531	54,400
Furniture and fixtures	17,456	15,910
Leasehold improvements	10,039	7,699
Construction-in-progress	8,565	7,313
<b>Total</b>	<b>148,809</b>	<b>136,368</b>
Less accumulated depreciation and amortization	(50,521)	(43,985)
<b>Property and equipment net</b>	<b>98,288</b>	<b>92,383</b>
<b>OTHER ASSETS:</b>		
Other intangibles - less accumulated amortization of \$2,085 and \$1,519, respectively	6,438	4,350
Goodwill	9,099	7,541
Other assets	2,844	2,656
Deferred income tax assets	3	2

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Deposits	84	90
Total other assets	18,468	14,639
<b>TOTAL ASSETS</b>	<b>\$ 193,165</b>	<b>\$ 182,668</b>

See notes to consolidated financial statements.

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## MERIT MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

SEPTEMBER 30, 2007 AND DECEMBER 31, 2006

(In Thousands - Unaudited)

	September 30, 2007	December 31, 2006
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Trade payables	10,158	10,598
Accrued expenses	9,880	8,464
Advances from employees	214	245
Deferred income tax liabilities	97	190
Income taxes payable	138	1,177
Total current liabilities	20,487	20,674
DEFERRED INCOME TAX LIABILITIES	5,541	5,469
LIABILITIES RELATED TO UNRECOGNIZED TAX POSITIONS	3,388	
DEFERRED COMPENSATION PAYABLE	2,893	2,869
DEFERRED CREDITS	2,134	2,239
OTHER LONG-TERM OBLIGATIONS	435	205
Total liabilities	34,878	31,456
<b>STOCKHOLDERS EQUITY:</b>		
Preferred stock 5,000 shares authorized as of September 30, 2007, no shares issued		
Common stock no par value; 50,000 shares authorized; 27,304 and 27,647 shares issued at September 30, 2007 and December 31, 2006, respectively	51,088	54,394
Retained earnings	107,220	96,969
Accumulated other comprehensive loss	(21)	(151)
Total stockholders equity	158,287	151,212
<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	<b>\$ 193,165</b>	<b>\$ 182,668</b>

See notes to consolidated financial statements.

## MERIT MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2007 AND 2006

(In Thousands Except Earnings Per Share - Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
NET SALES	\$ 50,584	\$ 46,697	\$ 153,425	\$ 139,858
COST OF SALES	30,801	28,629	95,247	85,743
GROSS PROFIT	19,783	18,068	58,178	54,115
OPERATING EXPENSES:				
Selling, general, and administrative	11,707	10,813	35,580	33,577
Research and development	1,990	2,119	6,561	6,221
Total operating expenses	13,697	12,932	42,141	39,798
INCOME FROM OPERATIONS	6,086	5,136	16,037	14,317
OTHER INCOME (EXPENSE):				
Interest income	96	69	248	179
Other income (expense)	4	20	2	(45)
Other income - net	100	89	250	134
INCOME BEFORE INCOME TAXES	6,186	5,225	16,287	14,451
INCOME TAX EXPENSE	1,891	1,900	5,427	5,203
NET INCOME	\$ 4,295	\$ 3,325	\$ 10,860	\$ 9,248
EARNINGS PER COMMON SHARE:				
Basic	\$ .16	\$ .12	\$ .40	\$ .34
Diluted	\$ .15	\$ .12	\$ .38	\$ .33
AVERAGE COMMON SHARES:				
Basic	27,327	27,363	27,453	27,274
Diluted	28,031	28,287	28,260	28,116

See notes to consolidated financial statements.





## MERIT MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2007 AND 2006

(In Thousands -Unaudited)

	2007	Nine Months Ended September 30,	2006
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income	\$	10,860	\$ 9,248
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization		6,890	6,078
Losses on sales and/or abandonment of equipment		252	161
Write-off of certain patents and trademarks		95	40
Amortization of deferred credits		(105)	(135)
Deferred income taxes		1,332	(373)
Stock-based compensation		759	1,196
Tax benefit attributable to appreciation of common stock options exercised		(216)	(508)
Changes in operating assets and liabilities net of effects from acquisitions:			
Trade receivables		1,139	2,267
Employee receivables		74	(48)
Other receivables		(690)	(178)
Inventories		2,422	(5,149)
Prepaid expenses and other assets		(425)	(534)
Income tax refund receivables		(16)	959
Deposits		6	2
Trade payables		(2,317)	85
Accrued expenses		1,305	230
Advances from employees		(38)	(111)
Income taxes payable		720	1,555
Liabilities related to unrecognized tax positions		(141)	
Other liabilities			(38)
Total adjustments		11,046	5,499
Net cash provided by operating activities		21,906	14,747
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Capital expenditures for:			
Property and equipment		(11,256)	(11,754)
Patents and trademarks		(143)	(236)
Increase in cash surrender value of life insurance contracts		(188)	(296)

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Proceeds from the sale of equipment	9	26
Cash paid in acquisitions	(4,218)	(2,802)
Net cash used in investing activities	(15,796)	(15,062)

See notes to consolidated financial statements.

## MERIT MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2007 AND 2006

(In Thousands - Unaudited)

	Nine Months Ended September 30,	
	2007	2006
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from:		
Issuance of common stock	\$ 1,127	\$ 1,805
Principal payments on long-term debt		1
Common stock repurchased and retired	(5,408)	
Increase in deferred compensation payable	24	230
Excess tax benefits from stock-based compensation	216	508
Net cash (used by) provided by financing activities	(4,041)	2,544
EFFECT OF EXCHANGE RATES ON CASH	292	131
NET INCREASE IN CASH AND CASH EQUIVALENTS	2,361	2,360
<b>CASH AND CASH EQUIVALENTS:</b>		
Beginning of period	9,838	4,645
End of period	\$ 12,199	\$ 7,005
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</b> Cash paid during		
the period for:		
Interest	\$ 3	\$ 7
Income taxes	\$ 3,520	\$ 3,019

## SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING AND FINANCING ACTIVITIES:

During the nine months ended September 30, 2007, we entered into a Distribution Agreement with GMA Company, Ltd ( GMA ), a Japanese corporation, for the exclusive distribution rights to sell a micro-catheter. In September, 2007, we paid \$500,000 in to GMA and have accrued an additional \$500,000 payable due upon receipt of certain information to assist in the filing of a Section 510(k) permitting application with the Food and Drug Administration ( FDA ). We also paid \$4,000 in September, 2007 to an outside firm for an asset valuation. An additional \$1.0 million is payable to GMA upon reaching certain milestones identified in the Distribution Agreement. Achievement of those milestones is not determinable at this time. The purchase price was allocated preliminarily to a distribution agreement for \$1,004,000.

Fair value of assets acquired	\$ 1,004,000
Cash paid	(504,000)
Accrued purchase price	(500,000)

Liabilities assumed

None

During the nine months ended September 30, 2007, we entered into a Patent Assignment and Royalty Agreement with Lightek Corporation, ( Lightek ) a Wyoming corporation, to manufacture and sell a radio-opaque band. We made an initial payment of \$228,000 to Lightek and an additional \$400,000 would be payable if we reach certain milestones identified in the Patent Assignment and Royalty Agreement. Achievement of the milestones is not certain at this time. In addition, we agreed to a royalty payment of 3% of net sales during the life of a pending patent. We have estimated a discounted royalty payment of \$75,000, over the life of the pending patent, using an incremental borrowing rate of 6%.

See notes to consolidated financial statements.

## MERIT MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOW

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2007 AND 2006

(In Thousands - Unaudited)

## SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING AND FINANCING ACTIVITIES (Continued):

Based on management's evaluation of the purchase agreement, we plan to record the royalty payments as an addition to the cost of the acquisition. We also plan to pay \$10,000 to an outside firm to complete an asset valuation. The purchase price will be allocated based on preliminarily fair values to developed technology for \$188,000, (Customer Relationships) for \$470,000, and goodwill for \$55,000.

Fair value of assets acquired	\$	228,000
Cash paid		(228,000)
Liabilities assumed		None

During the nine months ended September 30, 2007, we acquired other intangibles (Customer Relationships) of Medrad Sweden, AB ( Medrad ), a Swedish company, in a purchase transaction for \$124,036. The purchase price was allocated to other intangibles (Customer Relationships) for \$124,036.

Fair value of assets acquired	\$	124,036
Cash paid		(124,036)
Liabilities assumed		None

During the nine months ended September 30, 2007, we entered into a distribution agreement with Milamy Partners LLC, ( Milamy ) a Maine corporation, wherein we purchased the exclusive, worldwide right to distribute their KanguruWeb® Abdominal Retraction System in vascular lab markets for \$350,000. As part of the distribution agreement, we received a customer list for the distribution agreements terminated by Milamy for their domestic and international sales to vascular labs. The purchase price was allocated to other intangibles (Customer Relationships) for \$350,000.

Fair value of assets acquired	\$	350,000
Cash paid		(350,000)
Liabilities assumed		None

During the nine months ended September 30, 2007, we entered into an asset purchase agreement with Datascope Corporation, ( Datascope ) a New Jersey corporation, to purchase its ProGuide catheter in a purchase transaction for \$3,290,731, including future minimum royalty payments of \$279,181. In connection with this agreement we acquired assets, inventory, a customer list, patents and a trademark. The purchase price was allocated based on estimated fair values to fixed assets for \$25,971, inventory for \$806,508, a customer list for \$230,000, patents for \$480,000, a trademark for \$130,000, a covenant not to compete for \$60,000 and goodwill for \$1,558,252.

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Fair value of assets acquired (including goodwill of \$1,558,252)	\$	3,290,731
Cash paid		(3,011,550)
Liabilities assumed	\$	(279,181)

During the nine months ended September 30, 2006, we acquired certain assets and other intangibles (Customer Relationships) of Hypoguard USA, Inc. ( Hypoguard ) in a purchase transaction for \$1,290,077. The purchase price was preliminarily allocated between fixed assets for \$178,573, inventory for \$149,821, a customer list for \$300,000 and goodwill for \$661,683.

See notes to consolidated financial statements.

**MERIT MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**

CONSOLIDATED STATEMENTS OF CASH FLOW

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2007 AND 2006

(In Thousands - Unaudited)

SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING AND FINANCING ACTIVITIES (Continued):

Fair value of assets acquired (including goodwill of \$661,683)	\$	1,290,077
Cash paid		(790,077)
Accrued purchase price		(500,000)
Liabilities assumed		None

During the nine months ended September 30, 2006, we acquired certain assets of Millimed A/S, a corporation organized under the laws of Denmark, and Millimed Holdings, Inc., a Delaware corporation, (together Millimed ) in a purchase transaction for \$1,510,878. The purchase price was preliminarily allocated between fixed assets for \$135,590, inventory for \$461,790 and goodwill for \$913,498.

Fair value of assets acquired (including goodwill of \$913,498)	\$	1,510,878
Cash paid		(1,510,878)
Liabilities assumed		None

During the nine months ended September 30, 2006, we acquired certain know-how and formulas from a medical device company to produce a medical product in a purchase transaction for approximately \$742,501. The purchase price was allocated to other intangibles (Product Technology) for \$742,501. We have accrued for an additional purchase price payment of \$241,464 in other payables.

Fair value of assets acquired	\$	742,501
Cash paid		(501,037)
Accrued purchase price		(241,464)
Liabilities assumed		NONE

As of September 30, 2007 and 2006, \$1.0 million and \$1.6 million, respectively, of additions to plant, equipment, and other asset purchases were accrued as accounts payable.

See notes to consolidated financial statements.





## MERIT MEDICAL SYSTEMS, INC. AND SUBSIDIARIES

## 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 nine-month periods ended September 30, 2007 and 2006 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 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 September 30, 2007, and our results of operations and cash flows for the three and nine-month periods ended September 30, 2007 and 2006. The results of operations for the three and nine-month periods ended September 30, 2007 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, 2006 filed with the Securities and Exchange Commission (the SEC ).

**Reclassifications.** Certain other amounts have been reclassified in the prior year's financial statements to conform with the current year's presentation.

**2. Inventories.** Inventories are stated at the lower of cost or market. Inventories at September 30, 2007 and December 31, 2006 consisted of the following (in thousands):

	September 30, 2007	December 31, 2006
Finished goods	\$ 20,031	\$ 20,524
Work-in-process	5,457	3,714
Raw materials	11,306	14,324
Total	\$ 36,794	\$ 38,562

**3. Reporting Comprehensive Income.** Comprehensive income for the three and nine-month periods ended September 30, 2007 and 2006 consisted of net income and foreign currency translation adjustments. As of September 30, 2007 and December 31, 2006, the cumulative effect of such adjustments reduced stockholders' equity by \$21,073 and \$151,048, respectively. Comprehensive income for the three and nine-month periods ended September 30, 2007 and 2006 has been computed as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Net income	\$ 4,295	\$ 3,325	\$ 10,860	\$ 9,248
Foreign currency translation	96	(15)	130	131
Comprehensive income	\$ 4,391	\$ 3,310	\$ 10,990	\$ 9,379

**4. Stock-based Compensation.** Stock-based compensation expense for the three and nine-month periods ended September 30, 2007 and 2006 has been computed as follows (in thousands):

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	Three Months Ended September 30,				Nine Months Ended September 30,			
	2007		2006		2007		2006	
Cost of goods sold	\$	76	\$	88	\$	149	\$	313
Research and development		36		44		65		134
Selling, general and administrative		251		300		545		749
Total pre-tax stock expense	\$	363	\$	432	\$	759	\$	1,196

This stock-based compensation created a tax benefit of \$38,000 and \$216,000 for the three and nine-month periods ended September 30, 2007, respectively, when compared to \$147,000 and \$508,000 for the three and nine-month periods ended September 30, 2006, respectively. As of September 30, 2007, the total remaining

unrecognized compensation cost related to non-vested stock options, net of forfeitures, was approximately \$2.8 million and is expected to be recognized over a weighted average period of 3.51 years. During the nine months ended September 30, 2007 there were 419,500 options of Merit common stock granted. We use the Black-Scholes method to value the stock compensation expense for options. In applying the Black-Scholes methodology to the option grants, we used the following assumptions:

	Ended September 30,	
	2007	2006
Risk-free interest rate	4.61%-5.00%	4.98%
Expected option life	6 years	6.08 years
Expected price volatility	46.3%-47.8%	41.90%

The average risk-free interest rate is determined using the U.S. Treasury rate in effect as of the date of grant, based on the expected term of the stock option. We determined the expected term of the stock options using the historical exercise behavior of employees. The expected price volatility was determined 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.

**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) for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Weighted-average shares outstanding used for calculation of net income per share-basic	27,327	27,363	27,453	27,274
Common stock equivalents	704	924	807	842