ADVANCED MEDICAL OPTICS INC
Form 10-Q
May 05, 2003
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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 March 28, 2003

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

FOR THE QUARTER ENDED	**COMMISSION FILE NUMBER**
MARCH 28, 2003	**001-31257**

ADVANCED MEDICAL OPTICS, INC.

A DELAWARE CORPORATION	**IRS EMPLOYER IDENTIFICATION**
	33-0986820

1700 E. ST. ANDREW PLACE, SANTA ANA, CALIFORNIA 92705

TELEPHONE NUMBER 714/247-8200

Indicate by a 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.

x **Yes** ¨ **No**

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

¨ **Yes** x **No**

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

As of May 1, 2003, there were 29,003,387 shares of common stock outstanding.

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FORM 10-Q FOR THE QUARTER ENDED MARCH 28, 2003

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PART I - FINANCIAL INFORMATION

Advanced Medical Optics, Inc.

Unaudited Condensed Consolidated Statements of Operations

(In thousands, except per share data)

	Three Months Ended	
	March 28, 2003	March 29, 2002
Net sales	$ 131,176	$ 113,997
Cost of sales	50,020	44,276
Gross profit	81,156	69,721
Selling, general and administrative	67,608	54,170
Research and development	8,784	6,984
Operating income	4,764	8,567
Non-operating expense (income)		
Interest expense	4,851	681
Unrealized loss on derivative instruments	301	213
Other, net	(236)	51
	4,916	945
Earnings (loss) before income taxes	(152)	7,622
Provision (benefit) for income taxes	(59)	2,896
Net earnings (loss)	$ (93)	$ 4,726
Net loss per share (note 1):		
Basic and diluted	$ (0.00)	
Weighted average number of shares outstanding:		
Basic and diluted	28,749	

See accompanying notes to unaudited condensed consolidated financial statements.

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Advanced Medical Optics, Inc.

Unaudited Condensed Consolidated Balance Sheets

(In thousands, except share data)

	March 28, 2003	December 31, 2002
ASSETS		
Current assets		
Cash and equivalents	$ 55,671	$ 80,578
Trade receivables, net	120,063	121,607
Inventories	46,251	46,129
Other current assets	21,780	26,180
Total current assets	243,765	274,494
Property, plant and equipment, net	39,647	39,830
Other assets	43,689	45,274
Goodwill and intangibles, net	103,292	103,608
Total assets	$ 430,393	$ 463,206
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Current portion of long-term debt	$ 500	$ 750
Accounts payable	40,334	42,356
Accrued compensation	13,740	17,651
Other accrued expenses	43,018	47,447
Total current liabilities	97,592	108,204
Long-term debt, net of current portion	252,352	277,559
Other liabilities	12,296	11,759
Commitments and contingencies		
Stockholders equity:		
Preferred stock, $.01 par value; authorized 5,000,000 shares; none issued		
Common stock, $.01 par value; authorized 120,000,000 shares; issued 28,848,399 and 28,723,512 shares	288	287
Additional paid-in capital	48,095	47,455
Retained earnings	14,531	14,624
Accumulated other comprehensive income	5,357	3,331
	68,271	65,697
Less treasury stock, at cost (12,708 and 3,151 shares)	(118)	(13)
Total stockholders equity	68,153	65,684
Total liabilities and stockholders equity	$ 430,393	$ 463,206

See accompanying notes to unaudited condensed consolidated financial statements.

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Advanced Medical Optics, Inc.

Unaudited Condensed Consolidated Statements of Cash Flows

(In thousands)

	Three Months Ended	
	March 28, 2003	March 29, 2002
Cash flows provided by operating activities:		
Net earnings (loss)	$ (93)	$ 4,726
Non cash items included in net earnings (loss):		
Amortization of original issue discount and debt issuance costs	449	
Amortization of realized gain on interest rate swaps	(184)	
Depreciation and amortization	3,891	3,355
Loss on investments and assets	260	216
Unrealized loss on derivatives	301	213
Changes in assets and liabilities:		
Trade receivables	2,519	18,369
Inventories	56	(2,785)
Other current assets	4,161	6,054
Accounts payable	(2,143)	(9,894)
Accrued expenses and other liabilities	(5,972)	(2,057)
Other non-current assets	(472)	477
Net cash provided by operating activities	2,773	18,674
Cash flows from investing activities:		
Additions to property, plant and equipment	(1,753)	(460)
Additions to capitalized internal-use software	(31)	(632)
Additions to demonstration and bundled equipment	(1,607)	(1,062)
Net cash used in investing activities	(3,391)	(2,154)
Cash flows from financing activities:		
Repayment of long-term debt	(25,000)	
Proceeds from issuance of common stock	641	
Purchase of treasury stock	(105)	
Distributions to Allergan, Inc., net of advances		(18,278)
Net cash used in financing activities	(24,464)	(18,278)
Effect of exchange rates on cash and equivalents	175	(363)
Net decrease in cash and equivalents	(24,907)	(2,121)
Cash and equivalents at beginning of period	80,578	6,957
Cash and equivalents at end of period	$ 55,671	$ 4,836
Supplemental disclosure of cash flow information		
Cash paid for:		
Interest	$ 10,905	$ 819

Income taxes	$	$ 513

See accompanying notes to unaudited condensed consolidated financial statements.

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Advanced Medical Optics, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements

Note 1: Description of Business

Advanced Medical Optics, Inc. (AMO or the Company) develops, manufactures and markets surgical devices for the eyes, with a focus on devices that are used to perform cataract surgery, a surgery in which the natural focusing lens of the eye, having become hard and clouded, is broken up and removed and subsequently replaced with an artificial lens. The Company also offers a broad range of eye care products for use with virtually all available types of contact lenses. These products include disinfecting solutions to destroy harmful microorganisms in and on the surface of contact lenses, daily cleaners to remove undesirable film and deposits from contact lenses, enzymatic cleaners to remove protein deposits from contact lenses and lens rewetting drops to provide added wearing comfort.

The Company has operations in approximately 20 countries and sells its products in approximately 60 countries. On June 29, 2002, Allergan, Inc. (Allergan) transferred its optical medical device business consisting of the ophthalmic surgical and eye care product lines to the Company in connection with a tax-free spin-off. References to the Company and AMO refer to Allergan s optical medical device business for the quarter ended March 29, 2002 and to AMO and its subsidiaries for the periods subsequent to the spin-off.

No earnings per share data for the three months ended March 29, 2002 is presented as the Company s earnings were part of Allergan s earnings through the close of business on June 28, 2002.

Note 2: Basis of Presentation

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments necessary (consisting only of normal recurring accruals) to present fairly the financial information contained therein. These statements do not include all disclosures required by accounting principles generally accepted in the United States of America for annual financial statements and should be read in conjunction with the audited consolidated financial statements of the Company for the year ended December 31, 2002. The results of operations for the three months ended March 28, 2003 are not necessarily indicative of the results to be expected for the year ending December 31, 2003.

Prior to the spin-off, Allergan did not account for the business that comprises AMO on the basis of separate legal entities, subsidiaries, divisions or segments. The accompanying unaudited condensed consolidated statement of operations for the three month period ended March 29, 2002 includes those revenues and expenses directly attributable to AMO s operations and allocations of certain Allergan corporate expenses to AMO. These amounts were allocated to AMO on the basis that was considered by Allergan management to reflect most fairly or reasonably the utilization of the services provided to or the benefit obtained by the Company. All material intercompany balances have been eliminated.

Note 3: Recently Adopted Accounting Standards

In July 2002, Statement of Financial Accounting Standards No. 146, Accounting for Costs Associated with Exit or Disposal Activities (SFAS No. 146), was issued. SFAS No. 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. Examples of costs covered by the standard include lease termination costs and certain employee severance costs that are associated with a restructuring, discontinued operation, plant closing, or other exit or disposal activity. The Company adopted SFAS No. 146 during the quarter ended March 28, 2003. The adoption of SFAS No. 146 did not have a material effect on the Company s consolidated financial statements.

In December 2002, Statement of Financial Accounting Standards No. 148, Accounting for Stock-Based Compensation (SFAS No. 148), was issued. SFAS No. 148 amends the disclosure requirements of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (SFAS No. 123), to require prominent disclosures in both interim and annual financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. SFAS No. 148 also amends SFAS No. 123 to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. The Company has commenced quarterly footnote disclosure of the fair value based method of accounting for stock-based employee compensation beginning with the quarter ended March 28, 2003. The pro forma effect to net loss is presented in Note 6 as if the fair value method had been applied. As the Company decided not to adopt the SFAS No. 123 fair value method of accounting for stock-based employee compensation, the new transition alternatives of SFAS No. 148 did not have an effect on the Company s consolidated financial statements.

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Advanced Medical Optics, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements (continued)

Note 4: Composition of Certain Financial Statement Captions

The components of inventories were as follows:

(In thousands)	March 28, 2003	December 31, 2002
Finished goods, including inventory on consignment with customers of $7,150 and $7,417 in 2003 and 2002, respectively	$ 40,691	$ 39,500
Work in process	1,077	1,441
Raw materials	4,483	5,188
	$ 46,251	$ 46,129

The components of amortizable intangibles and goodwill were as follows:

Intangibles

	March 28, 2003		December 31, 2002	
(In thousands)	Gross Amount	Accumulated Amortization	Gross Amount	Accumulated Amortization
Amortized Intangible Assets:				
Licensing	$ 3,940	$ (3,940)	$ 3,940	$ (3,940)
Trademarks	572	(113)	652	(87)
	$ 4,512	$ (4,053)	$ 4,592	$ (4,027)

Amortization expense of intangible assets for the quarters ended March 28, 2003 and March 29, 2002 was approximately $26,000 and $76,000, respectively.

Estimated amortization expense of intangible assets is as follows: $106,000 each year between 2003 and 2006 and $61,000 in 2007.

Goodwill

(In thousands)	**March 28, 2003**	**December 31, 2002**
Goodwill:		
United States	$ 12,783	$ 12,783
Japan	25,264	25,474
Manufacturing operations	64,786	64,786
	$ 102,833	$ 103,043

There was no activity related to goodwill during the three months ended March 28, 2003, except for the impact of foreign currency fluctuations.

Note 5: Debt, Interest Rate Swap Agreements and Guarantor Subsidiaries

At March 28, 2003, the Company had $197.5 million, net of $2.5 million of original issue discount, of 9-1/4% senior subordinated notes due July 15, 2010 outstanding. In addition, the Company has a senior credit facility, consisting of an initial $100.0 million term loan and a $35.0 million revolving line of credit. The Company has repaid $50.0 million of the term loan resulting in an outstanding balance of $50.0 million as of March 28, 2003. Approximately $18.3 million of the revolving line of credit has been reserved to support letters of credit issued on the Company s behalf.

The senior credit facility provides that the Company will maintain certain financial and operating covenants which include, among other provisions, maintaining specific leverage and interest coverage ratios. Certain covenants under the senior credit facility and the indenture relating to the senior subordinated notes also limit the incurrence of additional indebtedness. The senior credit facility prohibits dividend payments. The Company was in compliance with these covenants at March 28, 2003.

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Advanced Medical Optics, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements (continued)

The aggregate maturities of total long-term debt are as follows: $0.5 million each year between 2003 and 2006; $24.0 million in 2007 and $224.0 million after 2007.

The Company has entered into various interest rate swap agreements which effectively convert the interest rate on $150.0 million of the senior subordinated notes from a fixed to a floating rate and convert the interest rate on the $50.0 million of term loan borrowings from a floating rate to a fixed rate. The interest rate swaps have maturity dates beginning in 2005 and qualify as either fair value or cash flow hedges. Changes in fair value of the interest rate swap agreement qualifying as a cash flow hedge are recorded in other comprehensive income to the extent such changes are effective and as long as the cash flow hedge requirements are met.

At March 28, 2003, the fair value of $0.1 million of the interest rate swap qualifying as a fair value hedge is included in Other assets. An offsetting $0.1 million credit is included in long-term debt as a fair value adjustment. At March 28, 2003, the fair value of $(2.0) million of the interest rate swap qualifying as a cash flow hedge is recorded in Other liabilities.

In October 2002, the Company realized the value of certain interest rate swaps qualifying as fair value hedges. The Company received approximately $10.4 million, of which approximately $4.8 million represented the net settlement of the accrued but unpaid amount between the Company and the swap counterparties. The remaining amount of approximately $5.6 million was recorded as an adjustment to the carrying amount of the senior subordinated notes as a premium and is amortized over the remaining life of the notes. Concurrently, the Company entered into a new interest rate swap agreement effective October 31, 2002 which converts the interest rate on $150.0 million of the senior subordinated notes from a fixed to a floating rate. At March 28, 2003, the unamortized realized gain on the interest rate swaps was $5.3 million.

In connection with the issuance of the senior subordinated notes, one of the Company s subsidiaries (the Guarantor Subsidiary) jointly, fully, severally and unconditionally guaranteed such notes. Pursuant to the Securities and Exchange Commission regulations, certain condensed financial information about the Parent, Guarantor Subsidiary and Non-Guarantor Subsidiaries is required to be disclosed. The following provides this required financial information subsequent to the spin-off.

Condensed Consolidated Statement of Operations Quarter ended March 28, 2003 (in thousands)	**Parent**	**Guarantor Subsidiary**	**Non-Guarantor Subsidiaries**	**Eliminations**	**Consolidated**
Net sales	$ 43,918		126,327	(39,069)	$ 131,176
Operating costs and expenses:					
Cost of sales	20,982		57,916	(28,878)	50,020
Selling, general and administrative	23,396		44,213	(1)	67,608
Research and development	7,753		1,031		8,784

Operating income (loss)	(8,213)		23,167	(10,190)	4,764
Non-operating income (expense)	13,380		14,214	(32,510)	(4,916)
Earnings (loss) before income taxes	5,167		37,381	(42,700)	(152)
Provision (benefit) for income taxes	(100)		395	(354)	(59)
Net earnings (loss)	$ 5,267		36,986	(42,346)	$ (93)

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Advanced Medical Optics, Inc.

Notes to Unaudited Condensed Consolidated Financial Statements (continued)

Condensed Consolidated Balance Sheet March 28, 2003 (In thousands)	**Parent**	**Guarantor Subsidiary**	**Non-Guarantor Subsidiaries**	**Eliminations**	**Consolidated**
Assets:					
Cash and equivalents	$ 9,464		46,207		$ 55,671
Trade receivables, net	16,729		103,334		120,063
Inventories	17,841		28,410		46,251
Other current assets	11,061		10,719		21,780
Total current assets	55,095		188,670		243,765
Property, plant and equipment, net	13,407		26,240		39,647
Other assets	273,799	200,614	229,551	(660,275)	43,689
Goodwill and intangibles, net	13,111		123,858	(33,677)	103,292
Total assets	$ 355,412	200,614	568,319	(693,952)	$ 430,393
Liabilities and stockholders equity:					
Current portion of long-term debt	$ 500				$ 500
Accounts payable and accrued expenses	4,555		80,637	11,900	97,092
Total current liabilities	5,055		80,637	11,900	97,592
Long-term debt, net of current portion	252,352				252,352
Other liabilities	6,115		6,181		12,296
Total liabilities	263,522		86,818	11,900	362,240
Total stockholders equity	91,890	200,614	481,501	(705,852)	68,153
Total liabilities and stockholders equity	$ 355,412	200,614	568,319	(693,952)	$ 430,393

Condensed Consolidated Balance Sheet December 31, 2002 (In thousands)	**Parent**	**Guarantor Subsidiary**	**Non-Guarantor Subsidiaries**	**Eliminations**	**Consolidated**
Assets:					
Cash and equivalents	$ 5,388		75,190		$ 80,578
Trade receivables, net	20,152		101,455		121,607
Inventories	20,092				