

ADVANCED MEDICAL OPTICS INC
Form 10-Q
May 09, 2007

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 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 001-31257

ADVANCED MEDICAL OPTICS, INC.

(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction
of incorporation or organization)

33-0986820
(I.R.S. Employer
Identification No.)

1700 E. St. Andrew Place

Santa Ana, California

92705

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(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code 714/247-8200

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 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. (Check one):

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). Yes ☐ No ☒

As of April 30, 2007, there were 59,940,915 shares of common stock outstanding.

ADVANCED MEDICAL OPTICS, INC.

FORM 10-Q FOR THE QUARTER ENDED MARCH 30, 2007

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PART I FINANCIAL INFORMATION**Item 1. Financial Statements**

Advanced Medical Optics, Inc.

Unaudited Consolidated Statements of Operations

(In thousands, except per share data)

	Three Months Ended	
	March 30,	March 31,
	2007	2006
Net sales	\$ 251,673	\$ 238,228
Cost of sales (Note 3)	94,167	86,835
Gross profit	157,506	151,393
Selling, general and administrative	109,518	95,439
Research and development	19,164	16,973
In-process research and development	1,580	
Business repositioning costs, net (Note 3)		29,254
Operating income	27,244	9,727
Non-operating expense:		
Interest expense	6,164	4,507
Unrealized loss on derivative instruments	383	438
Other, net	1,216	1,004
	7,763	5,949
Earnings before income taxes	19,481	3,778
Provision for income taxes	7,372	1,149
Net earnings	\$ 12,109	\$ 2,629
Net earnings per share:		
Basic	\$ 0.20	\$ 0.04
Diluted	\$ 0.20	\$ 0.04
Weighted average number of shares outstanding:		
Basic	59,399	68,228
Diluted	61,044	71,026

See accompanying notes to unaudited consolidated financial statements.

Advanced Medical Optics, Inc.

Unaudited Consolidated Balance Sheets

(In thousands, except share data)

	March 30, 2007	December 31, 2006
ASSETS		
Current assets:		
Cash and equivalents	\$ 43,899	\$ 34,522
Trade receivables, net	216,131	232,408
Inventories	127,600	127,532
Deferred income taxes	41,744	41,698
Income tax receivable	18,680	15,045
Other current assets	22,114	26,938
Total current assets	470,168	478,143
Property, plant and equipment, net	135,354	132,756
Deferred income taxes	11,861	13,260
Other assets	74,168	69,365
Intangible assets, net	467,023	471,664
Goodwill	848,113	848,709
Total assets	\$ 2,006,687	\$ 2,013,897
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 47,679	\$ 53,897
Accrued compensation	28,784	41,896
Other accrued expenses	106,315	120,384
Deferred income taxes	1,245	1,276
Total current liabilities	184,023	217,453
Long-term debt	851,105	851,105
Deferred income taxes	181,486	185,844
Other liabilities	51,810	43,504
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$.01 par value; 5,000,000 shares authorized; none issued		
Common stock, \$.01 par value; 240,000,000 shares authorized; 59,825,012 and 59,512,106 shares issued	598	595
Additional paid-in capital	1,421,622	1,409,475
Accumulated deficit	(718,411)	(730,800)
Accumulated other comprehensive income	34,478	36,745
Treasury stock, at cost (1,397 shares)	(24)	(24)
Total stockholders' equity	738,263	715,991
Total liabilities and stockholders' equity	\$ 2,006,687	\$ 2,013,897

See accompanying notes to unaudited consolidated financial statements.

Advanced Medical Optics, Inc.

Unaudited Consolidated Statements of Cash Flows

(In thousands)

	Three Months Ended	
	March 30, 2007	March 31, 2006
Cash flows from operating activities:		
Net earnings	\$ 12,109	\$ 2,629
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:		
Amortization of debt issuance costs	975	839
Depreciation and amortization	17,116	16,482
In-process research and development	1,580	
Loss on investments and assets	375	2,539
Deferred income taxes	(1,474)	(1,500)
Unrealized loss on derivatives	383	438
Share-based compensation	4,746	5,071
Changes in assets and liabilities (net of effect of business acquired):		
Trade receivables, net	19,741	15,594
Inventories	1,680	(3,331)
Other current assets	4,761	2,882
Accounts payable	(7,703)	(8,260)
Accrued expenses and other liabilities	(27,284)	(24,595)
Income taxes	3,123	(3,626)
Other non-current assets and liabilities	(5,312)	(5,948)
Net cash provided by (used in) operating activities	24,816	(786)
Cash flows from investing activities:		
Acquisition of businesses, net of cash acquired	(13,540)	
Additions to property, plant and equipment	(7,188)	(6,575)
Proceeds from sale of property, plant and equipment	21	
Additions to capitalized internal-use software	(915)	
Additions to demonstration and bundled equipment	(1,942)	(2,406)
Net cash used in investing activities	(23,564)	(8,981)
Cash flows from financing activities:		
Net repayment of short-term debt		(15,000)
Proceeds from issuance of common stock	5,989	15,918
Excess tax benefits from share-based compensation	1,082	5,229
Net cash provided by financing activities	7,071	6,147
Effect of exchange rates on cash and equivalents	1,054	401
Net increase (decrease) in cash and equivalents	9,377	(3,219)
Cash and equivalents at beginning of period	34,522	40,826
Cash and equivalents at end of period	\$ 43,899	\$ 37,607

See accompanying notes to unaudited consolidated financial statements.

Advanced Medical Optics, Inc.

Notes to Unaudited Consolidated Financial Statements

Note 1: Basis of Presentation

In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments necessary (consisting only of normal, recurring adjustments) for a fair statement of 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 Advanced Medical Optics, Inc. (the Company or AMO) for the year ended December 31, 2006. The results of operations for the three months ended March 30, 2007 are not necessarily indicative of the results to be expected for the year ending December 31, 2007.

All material intercompany balances have been eliminated.

Reclassification

Certain prior period amounts have been reclassified to conform with current period presentation.

Recently Adopted and Issued Accounting Standards

The Company adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), on January 1, 2007 and recorded an increase in retained earnings of \$0.3 million related to the cumulative effect of adoption. The components of the cumulative effect of adoption included an increase of \$1.8 million in the gross liability for unrecognized tax benefits, an increase in gross deferred tax assets of \$3.5 million and a decrease in goodwill of \$1.4 million.

As of the adoption date, the Company had unrecognized tax benefits of \$30.1 million of which \$20.2 million, if recognized, would affect the effective tax rate. As of March 30, 2007, the Company had unrecognized tax benefits of \$31.3 million of which \$21.1 million, if recognized, would affect the effective tax rate. The difference primarily relates to timing differences and amounts arising from business combinations which, if recognized, would be recorded to goodwill.

We conduct business globally and, as a result, the Company or one or more of our subsidiaries files income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. In the normal course of business we are subject to examination by taxing authorities throughout the world, including such major jurisdictions as the United States, Ireland, Japan, Germany, China, and Netherlands. With few exceptions, we are no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations for years before 1999.

The Company anticipates that the total amount of liability for unrecognized tax benefits may change due to the settlement of audits and the expiration of statute of limitations in the next 12 months. Quantification of such change cannot be estimated at this time.

The Company recognizes potential accrued interest and penalties related to unrecognized tax benefits in income tax expense. As of the date of adoption, the Company had a liability for interest and penalties of \$1.4 million (net of tax). As of March 30, 2007, the Company had a liability for interest and penalties of \$1.6 million (net of tax).

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 (SFAS No. 159). SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. This Statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company is currently assessing the impact (if any) of SFAS No. 159 on its financial statements.

Note 2: Common Stock

AMO has an Incentive Compensation Plan (ICP) that provides for the granting of stock options, restricted stock and restricted stock units to directors, employees and consultants. The Company has two Employee Stock Purchase Plans (ESPP) for United States and international employees, respectively, which allow employees to purchase AMO common stock.

Share-Based Compensation Expense

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Total share-based compensation expense included in the unaudited consolidated statements of operations for the three months ended March 30, 2007 and March 31, 2006 was as follows (in thousands):

	Three Months Ended March 30, 2007	Three Months Ended March 31, 2006
Cost of sales	\$ 581	\$ 540
Operating Expenses -		
Research and development	590	480
Selling, general and administrative	3,575	4,051
	4,165	4,531
Pre-tax expense	4,746	5,071
Income tax benefit	(1,474)	(1,683)
Net of tax expense	\$ 3,272	\$ 3,388

Stock Options

Stock options granted to employees are exercisable at a price equal to the fair market value of the common stock on the date of the grant and generally vest at a rate of 25% per year beginning twelve months after the date of grant. Grants under these plans expire ten years from the date of grant.

The Company issues new shares to satisfy option exercises.

The following is a summary of stock option activity (in thousands, except per share amounts):

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term in Years	Aggregate Intrinsic Value
Outstanding at December 31, 2006	7,628	\$ 25.16		
Granted	18	38.34		
Exercised	(310)	19.26		
Forfeitures and cancellations	(20)	36.26		
Expirations	(3)	36.33		
Outstanding at March 30, 2007	7,313	25.40	6.08	\$ 86,306
Vested and expected to vest at March 30, 2007	7,205	25.21	6.09	\$ 86,362
Exercisable at March 30, 2007	5,047	\$ 19.87	5.23	\$ 87,475

Note 3: Product Rationalization and Business Repositioning