INVERNESS MEDICAL INNOVATIONS INC
Form 10-Q/A
February 14, 2005

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q/A

(Amendment No. 1)

(Mark One)

ý **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

for the quarterly period ended September 30, 2004

OR

o **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 001-16789

INVERNESS MEDICAL INNOVATIONS, INC.

(Exact Name Of Registrant As Specified In Its Charter)

DELAWARE	**04-3565120**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

51 SAWYER ROAD, SUITE 200
WALTHAM, MASSACHUSETTS 02453
(Address of principal executive offices)

(781) 647-3900
(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 ý No o

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

Yes ý No o

The number of shares outstanding of the registrant's common stock as of November 5, 2004 was 20,340,122.

INVERNESS MEDICAL INNOVATIONS, INC.
FORM 10-Q
For the Quarterly Period Ended September 30, 2004

This quarterly report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Readers can identify these statements by forward-looking words such as "may," "could," "should," "would," "intend," "will," "expect," "anticipate," "believe," "estimate," "continue" or similar words. There are a number of important factors that could cause actual results of Inverness Medical Innovations, Inc. and its subsidiaries to differ materially from those indicated by such forward-looking statements. These factors include, but are not limited to, the risk factors detailed in this quarterly report on Form 10-Q and other risk factors identified from time to time in our periodic filings with the Securities and Exchange Commission. Readers should carefully review the factors discussed in the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations Certain Factors Affecting Future Results" and "Special Statement Regarding Forward-Looking Statements" beginning on pages 45 and 61, respectively, in this quarterly report on Form 10-Q and should not place undue reliance on our forward-looking statements. These forward-looking statements are based on information, plans and estimates at the date of this report. We undertake no obligation to update any forward-looking statements to reflect changes in underlying assumptions or factors, new information, future events or other changes.

Unless the context requires otherwise, references in this quarterly report on Form 10-Q to "we," "us," and "our" refer to Inverness Medical Innovations, Inc. and its subsidiaries.

We have registered or are using the following trademarks which appear in this quarterly report on Form 10-Q: Clearblue , Clearblue Easy®, Fact plus®, Persona®, Clearview®, Wampole®, Testpack , Signify®, Ferro-Sequels , Stresstabs®, Protegra®, Posture®, SoyCare , ALLBEE®, and Z-BEC®.

The following are registered trademarks of parties other than us: Abbott®, Abbott TestPack®, Abbott TestPack plus® and e.p.t®.

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EXPLANATORY NOTE

On December 2, 2004, we announced that our previously issued consolidated financial statements as of and for the years ended December 31, 2002 and 2003, and for the interim periods during 2004, contained an error in the application of accounting principles generally accepted in the United States of America relating to the calculation of our provision for income taxes and the related deferred taxes. In connection with a routine review of our Annual Report on Form 10-K for the fiscal year ended December 31, 2003, as amended ("Form 10-K"), by the Securities and Exchange Commission's Division of Corporation Finance, we also revised our purchase price allocation in connection with our acquisition of the rapid diagnostics business that we acquired from Abbott Laboratories on September 30, 2003 in order to attribute approximately $5.7 million to customer related intangible assets acquired in the acquisition and to reduce goodwill by the same amount. We have also recorded as of the date of the acquisition approximately $11.3 million in other assets acquired from Abbott Laboratories, the amortization of which amounted to approximately $50,000 per quarter, that we had originally recognized in our Quarterly Report on Form 10-Q for the period ended September 30, 2004 (the "Original Report"), and commenced amortization in connection with all amortizable acquired assets as of the same date. The impact of all additional non-cash amortization on our operating results, net of tax effect, was to reduce previously reported net income by approximately $800,000, or $0.04 per share, for the third quarter of 2004. This Amendment No. 1 (the "Amended Report") to Original Report has been filed to address both these issues in the Original Report and in the consolidated financial statements as of September 30, 2004 and for the three and nine months ended September 30, 2004 and 2003, respectively, contained therein. We have also amended our Form 10-K and our Quarterly Reports on Form 10-Q for the periods ended March 31, 2004 and June 30, 2004.

The correction of the error relating to our tax provision results in an incremental non-cash provision of income taxes. The changes to our purchase price allocation for the acquisition of the rapid diagnostics business from Abbott Laboratories result in additional non-cash amortization over the lives of the assets identified.

For the reasons discussed above, we are filing this Amended Report in order to amend Part I. Item 1 "Consolidated Financial Statements (unaudited)," Part I. Item 2 "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Part II. Item 6 "Exhibits and Reports on Form 8-K" of the Original Report to the extent necessary to reflect the adjustments discussed above. The remaining Items of our Original Report are not amended hereby and are repeated herein only for the reader's convenience.

In order to preserve the nature and character of the disclosures set forth in the Original Report, except as expressly noted above, this report speaks as of the date of the filing of the Original Report, November 9, 2004, and we have not updated the disclosures in this report to speak as of a later date. All information contained in this Amended Report is subject to updating and supplementing as provided in our reports filed with the SEC subsequent to the date of the Original Report.

PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

(in thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	**2003**	**2004**	**2003**
	(restated)	**(restated)**	**(restated)**	**(restated)**
Net product sales	$ 94,698	$ 69,278	$ 269,629	$ 196,182
License revenue	2,807	3,115	7,304	7,030
Net revenue	97,505	72,393	276,933	203,212
Cost of sales (Note 11)	59,171	40,902	166,686	113,217
Gross profit	38,334	31,491	110,247	89,995
Operating expenses:				
Research and development	7,850	6,413	23,265	17,055
Sales and marketing	14,824	13,251	42,836	36,949
General and administrative	13,053	7,637	38,510	24,013
Stock-based compensation(1)		60		66
Total operating expenses	35,727	27,361	104,611	78,083
Operating income	2,607	4,130	5,636	11,912
Interest expense, including amortization of discounts and write-off of deferred financing costs (Note 8)	(4,846)	(2,443)	(17,157)	(6,723)
Other income, net	1,179	367	1,655	6,387
(Loss) income before income taxes	(1,060)	2,054	(9,866)	11,576
Income tax provision	1,202	773	3,124	3,162
Net (loss) income	$ (2,262)	$ 1,281	$ (12,990)	$ 8,414
Net (loss) income available to common stockholders basic (Note 5)	$ (2,262)	$ 1,138	$ (13,739)	$ 7,956
Net (loss) income available to common stockholders diluted (Note 5)	$ (2,262)	$ 1,138	$ (13,739)	$ 8,091
Net (loss) income per common share basic (Note 5)	$ (0.11)	$ 0.07	$ (0.69)	$ 0.54

	Three Months Ended September 30,		Nine Months Ended September 30,	
Net (loss) income per common share diluted (Note 5)	$ (0.11)	$ 0.06	$ (0.69)	$ 0.48
Weighted average shares basic (Note 5)	20,296	16,301	19,813	14,719
Weighted average shares diluted (Note 5)	20,296	18,176	19,813	16,788

(1) The charge for stock-based compensation for the three and nine months ended September 30, 2003 was classified as general and administrative expenses.

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

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)
(in thousands, except per share amounts)

	September 30, 2004 (restated)	December 31, 2003 (restated)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 18,944	$ 24,622
Accounts receivable, net of allowances of $8,734 at September 30, 2004 and $7,492 at December 31, 2003	57,665	55,418
Inventories	57,668	47,423
Deferred tax assets	1,178	1,178
Prepaid expenses and other current assets	10,893	10,599
Total current assets	146,348	139,240
Property, plant and equipment, net	62,645	57,773
Goodwill	222,449	216,733
Other intangible assets with indefinite lives	50,092	46,719
Core technology and patents, net	40,920	37,942
Other intangible assets, net	28,965	32,679
Deferred financing costs, net, and other non-current assets	8,795	7,457
Deferred tax assets	495	1,456
Total assets	$ 560,709	$ 539,999
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	$ 52	$ 14,055
Current portion of capital lease obligations	458	457
Accounts payable	35,225	38,006
Accrued expenses and other current liabilities	45,066	41,122
Total current liabilities	80,801	93,640
Long-term liabilities:		
Long-term debt, net of current portion	198,128	159,838
Capital lease obligations, net of current portion	1,477	1,831
Deferred tax liabilities	11,511	9,118
Other long-term liabilities	4,981	3,307
Total long-term liabilities	216,097	174,094
Commitments and contingencies		
Series A redeemable convertible preferred stock, $0.001 par value:		
Authorized 2,667 shares		
Issued 2,527 shares at September 30, 2004 and December 31, 2003		
Outstanding none at September 30, 2004 and 208 shares at December 31, 2003		6,185
Stockholders' equity:		
Preferred stock, $0.001 par value:		
Authorized 2,333 shares, none issued		
Common stock, $0.001 par value:		
Authorized 50,000 shares		
Issued and outstanding 20,325 shares at September 30, 2004 and 19,640 shares at December 31, 2003	20	20

	September 30, 2004	December 31, 2003
Additional paid-in capital	353,060	341,703
Notes receivable from stockholders	(14,691)	(14,691)
Accumulated deficit	(86,500)	(72,765)
Accumulated other comprehensive income	11,922	11,813
Total stockholders' equity	263,811	266,080
Total liabilities and stockholders' equity	$ 560,709	$ 539,999

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

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(in thousands)

	Nine Months Ended September 30,	
	2004	**2003**
	(restated)	**(restated)**
Cash Flows from Operating Activities:		
Net (loss) income	$ (12,990)	$ 8,414
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Interest expense related to amortization and/or write-off of noncash original issue discount and deferred financing costs	4,380	1,133
Noncash gains related to interest rate swap and currency hedge agreements	(326)	(54)
Noncash stock-based compensation expense		66
Depreciation and amortization	17,641	10,930
Deferred income taxes	1,922	1,514
Other noncash items	(70)	(4)
Changes in assets and liabilities, net of acquisitions:		
Accounts receivable, net	(1,717)	(3,051)
Inventories	(9,274)	(3,668)
Prepaid expenses and other current assets	(189)	(2,937)
Accounts payable	(3,386)	353
Accrued expenses and other current liabilities	6,963	(6,817)
Increase in other long-term liabilities	489	
Net cash provided by operating activities	3,443	5,879
Cash Flows from Investing Activities:		
Purchases of property, plant and equipment	(15,403)	(8,427)
Proceeds from sale of property, plant and equipment	184	151
Payments for acquisitions and intellectual property	(12,275)	(76,141)
Increase in other assets	(1,129)	(44)
Net cash used in investing activities	(28,623)	(84,461)
Cash Flows from Financing Activities:		
Cash paid for financing costs	(5,333)	(3,772)
Proceeds from issuance of common stock, net of issuance costs	1,416	3,985
Proceeds from issuance of senior subordinated notes	150,000	
Proceeds from borrowings under senior credit facility		58,643
Net (repayments) proceeds from revolving lines of credit	(31,099)	18,524
Repayments of notes payable	(94,764)	(5,875)
Principal payments of capital lease obligations	(362)	(521)
Net cash provided by financing activities	19,858	70,984
Foreign exchange effect on cash and cash equivalents	(356)	1,767
Net decrease in cash and cash equivalents	(5,678)	(5,831)
Cash and cash equivalents, beginning of period	24,622	30,668
Cash and cash equivalents, end of period	$ 18,944	$ 24,837

	Nine Months Ended September 30,	
Supplemental Disclosure of Noncash Activities:		
Dividends, redemption interest and amortization of beneficial conversion feature related to preferred stock	$ 749	$ 458
Fair value of stock issued for acquisitions and intellectual property	$ 3,002	$ 75,305
Fair value of assumed and fully-vested stock options and warrants for acquisitions	$	$ 1,752
Conversion of preferred stock into common stock	$ 6,934	$

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

INVERNESS MEDICAL INNOVATIONS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

(1) Basis of Presentation of Financial Information

The accompanying consolidated financial statements of Inverness Medical Innovations, Inc. and its subsidiaries are unaudited. In the opinion of management, the unaudited consolidated financial statements contain all adjustments considered normal and recurring and necessary for their fair presentation. Interim results are not necessarily indicative of results to be expected for the year. These interim financial statements have been prepared in accordance with the instructions for Form 10-Q and therefore do not include all information and footnotes necessary for a complete presentation of operations, financial position, and cash flows in conformity with accounting principles generally accepted in the United States of America ("GAAP"). Our audited consolidated financial statements for the year ended December 31, 2003 included information and footnotes necessary for such presentation and were included in our annual report on Form 10-K/A, Amendment No. 3, filed with the Securities and Exchange Commission ("SEC") on February 11, 2005. These unaudited consolidated financial statements should be read in conjunction with our audited consolidated financial statements and notes thereto for the year ended December 31, 2003.

In connection with our restatements for the years ended December 31, 2003 and 2002, as discussed in our 2003 annual report on Form 10-K/A, Amendment No. 3, we also restated our consolidated financial statements for the three and nine months ended September 30, 2004 and 2003, respectively, to reflect corrections to our income tax provisions and adjustments to amortization expense resulting from revisions made to our purchase price allocation in connection with our acquisition of a business from Abbott as of September 30, 2003, the acquisition date. Such adjustments are reflected in the accompanying consolidated financial statements and discussed in Note 15 herein.

(2) Cash and Cash Equivalents

We consider all highly liquid cash investments with original maturities of three months or less at the date of acquisition to be cash equivalents. At September 30, 2004, our cash equivalents consisted of money market funds.

(3) Inventories

Inventories are stated at the lower of cost (first in, first out) or market and are comprised of the following:

(in thousands)	September 30, 2004	December 31, 2003
Raw materials	$ 24,633	$ 19,606
Work-in-process	14,212	12,631
Finished goods	18,823	14,806
	$ 57,668	$ 47,043

(4) Employee Stock-Based Compensation Arrangements

For all periods presented in the accompanying unaudited consolidated financial statements, we accounted for our employee stock-based compensation arrangements using the intrinsic value method under the provisions of Accounting Principles Board ("APB") Opinion No. 25, *Accounting for Stock Issued to Employees*, and in accordance with Financial Accounting Standards Board ("FASB") Interpretation ("FIN") No. 44, *Accounting for Certain Transactions Involving Stock Compensation*. We have elected to use the disclosure-only provisions of Statement of Financial Accounting Standards ("SFAS") No. 123, *Accounting for Stock-Based Compensation*, and SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure.*

Had compensation expense for stock option grants to employees been determined based on the fair value method at the grant dates for awards under the stock option plans consistent with the method prescribed by SFAS No. 123, our net (loss) income would have been (increased) decreased to the pro forma amounts indicated as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands, except per share amounts)	**2004**	**2003(b)**	**2004**	**2003(b)**
	(restated)	**(restated)**	**(restated)**	**(restated)**
Net (loss) income as reported	$ (2,262)	$ 1,281	$ (12,990)	$ 8,414
Stock-based employee compensation as reported (a)		15		16
Pro forma stock-based employee compensation	(1,563)	(1,388)	(4,368)	(3,609)
Net (loss) income pro forma	$ (3,825)	$ (92)	$ (17,358)	$ 4,821
(Loss) income per share basic:				
Net (loss) income per share as reported	$ (0.11)	$ 0.07	$ (0.69)	$ 0.54
Stock-based employee compensation as reported				
Pro forma stock-based employee compensation	(0.08)	(0.08)	(0.22)	(0.25)
Net (loss) income per share pro forma	$ (0.19)	$ (0.01)	$ (0.91)	$ 0.29
(Loss) income per share diluted:				
Net (loss) income per share as reported	$ (0.11)	$ 0.06	$ (0.69)	$ 0.48
Stock-based employee compensation as reported				
Pro forma stock-based employee compensation	(0.08)	(0.07)	(0.22)	(0.22)
Net (loss) income per share pro forma	$ (0.19)	$ (0.01)	$ (0.91)	$ 0.26

(a)

Stock-based employee compensat