WRIGHT MEDICAL GROUP INC
Form 10-Q
October 30, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2009

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: 000-32883

WRIGHT MEDICAL GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware	**13-4088127**
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification Number)
5677 Airline Road Arlington, Tennessee	**38002**
(Address of Principal Executive Offices)	(Zip Code)

(901) 867-9971

(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.

þ Yes o No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, 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.)

o Yes o 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. (Check one):

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

o Yes þ No

As of October 27, 2009, there were 38,629,287 shares of common stock outstanding.

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SAFE-HARBOR STATEMENT

This quarterly report contains forward-looking statements as defined under U.S. federal securities laws. These statements reflect management s current knowledge, assumptions, beliefs, estimates, and expectations and express management s current views of future performance, results, and trends and may be identified by their use of terms such as anticipate, believe, could, estimate, expect, intend, may, plan, predict, project, will, and oth Forward-looking statements are subject to a number of risks and uncertainties that could cause our actual results to materially differ from those described in the forward-looking statements. Such risks and uncertainties include those discussed in our filings with the Securities and Exchange Commission (including those described in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2008, under the heading, Risk Factors and elsewhere in this report). Readers should not place undue reliance on forward-looking statements. Such statements are made as of the date of this quarterly report, and we undertake no obligation to update such statements after this date.

PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (unaudited).

WRIGHT MEDICAL GROUP, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)
(unaudited)

	September 30, 2009	December 31, 2008
Assets:		
Current assets:		
Cash and cash equivalents	$ 121,234	$ 87,865
Marketable securities	40,440	57,614
Accounts receivable, net	110,288	102,046
Inventories	166,339	176,059
Prepaid expenses	10,916	14,263
Deferred income taxes	29,634	29,874
Other current assets	5,289	8,934
Total current assets	484,140	476,655
Property, plant and equipment, net	137,665	133,651
Goodwill	53,425	49,682
Intangible assets, net	18,072	21,090
Deferred income taxes	4,236	3,034
Other assets	7,818	8,018
Total assets	$ 705,356	$ 692,130
Liabilities and Stockholders Equity:		
Current liabilities:		
Accounts payable	$ 14,025	$ 15,877
Accrued expenses and other current liabilities	52,821	59,247
Current portion of long-term obligations	162	125
Total current liabilities	67,008	75,249
Long-term debt and capital lease obligations	200,144	200,136
Deferred income taxes	276	166
Other liabilities	3,663	4,951
Total liabilities	271,091	280,502
Commitments and contingencies (Note 10)		
Stockholders equity:		
Common stock, $.01 par value, authorized: 100,000,000 shares; issued and outstanding: 38,734,805 shares at September 30, 2009 and 38,021,961 shares	374	372

at December 31, 2008		
Additional paid-in capital	374,464	364,594
Accumulated other comprehensive income	21,181	18,312
Retained earnings	38,246	28,350
Total stockholders equity	434,265	411,628
	$ 705,356	$ 692,130

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

WRIGHT MEDICAL GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	**2008**	**2009**	**2008**
Net sales	$ 117,742	$ 111,096	$ 357,580	$ 345,438
Cost of sales [1]	35,880	32,038	110,646	99,287
Gross profit	81,862	79,058	246,934	246,151
Operating expenses:				
Selling, general and administrative [1]	63,703	61,897	196,133	197,361
Research and development [1]	8,537	8,338	26,460	24,715
Amortization of intangible assets	1,274	1,287	3,899	3,604
Restructuring charges (Note 9)	131	685	991	5,595
Acquired in-process research and development				2,490
Total operating expenses	73,645	72,207	227,483	233,765
Operating income	8,217	6,851	19,451	12,386
Interest expense, net	1,435	717	3,974	1,127
Other expense (income), net	108	(284)	(358)	(907)
Income before income taxes	6,674	6,418	15,835	12,166
Provision for income taxes	2,522	2,231	5,939	6,278
Net income	$ 4,152	$ 4,187	$ 9,896	$ 5,888
Net income per share (Note 7):				
Basic	$ 0.11	$ 0.11	$ 0.27	$ 0.16
Diluted	$ 0.11	$ 0.11	$ 0.26	$ 0.16
Weighted-average number of shares outstanding-basic	37,431	37,095	37,331	36,845
Weighted-average number of shares outstanding-diluted	37,551	38,037	37,395	37,536

[1] These line items include the following amounts of non-cash, stock-based

compensation expense for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	**2008**	**2009**	**2008**
Cost of sales	$ 335	$ 300	$ 938	$ 952
Selling, general and administrative	2,517	2,623	7,822	8,440
Research and development	480	430	1,440	1,096

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

WRIGHT MEDICAL GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(unaudited)

	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Operating activities:		
Net income	$ 9,896	$ 5,888
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	23,865	19,308
Stock-based compensation expense	10,200	10,488
Amortization of intangible assets	3,899	3,604
Acquired in-process research and development		2,490
Amortization of deferred financing costs	738	744
Deferred income taxes	(2,709)	(9,226)
Excess tax benefit from stock-based compensation arrangements	(24)	(1,277)
Non-cash restructuring charges		(63)
Other	(14)	288
Changes in assets and liabilities (net of acquisitions):		
Accounts receivable	(5,925)	(12,349)
Inventories	10,418	(51,642)
Marketable securities (trading securities)		15,535
Prepaid expenses and other current assets	8,200	1,802
Accounts payable	(1,968)	8,692
Accrued expenses and other liabilities	(6,465)	10,533
Net cash provided by operating activities	50,111	4,815
Investing activities:		
Capital expenditures	(26,360)	(43,524)
Acquisitions of businesses	(5,973)	(28,912)
Purchase of intangible assets	(882)	(1,918)
Redemption of (investment in) available-for-sale marketable securities	16,868	(19,952)
Disposition of assets held for sale		2,363
Net cash used in investing activities	(16,347)	(91,943)
Financing activities:		
Issuance of common stock	231	11,688
Principal payments of bank and other financing	(107)	(256)
Financing under factoring agreements, net	(58)	(414)
Excess tax benefit from stock-based compensation arrangements	24	1,277
Net cash provided by financing activities	90	12,295

Effect of exchange rates on cash and cash equivalents	(485)	(818)
Net increase (decrease) in cash and cash equivalents	33,369	(75,651)
Cash and cash equivalents, beginning of period	87,865	229,026
Cash and cash equivalents, end of period	$121,234	$153,375

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

WRIGHT MEDICAL GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. Summary of Significant Accounting Policies

Basis of Presentation. The unaudited condensed consolidated interim financial statements of Wright Medical Group, Inc. have been prepared in accordance with accounting principles generally accepted in the United States (U.S.) for interim financial information and the instructions to Quarterly Report on Form 10-Q and Rule 10-01 of Regulation S-X. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the U.S. have been condensed or omitted pursuant to these rules and regulations. Accordingly, these unaudited condensed consolidated interim financial statements should be read in conjunction with our consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2008, as filed with the U.S. Securities and Exchange Commission (SEC). In the opinion of management, these unaudited condensed consolidated interim financial statements reflect all adjustments necessary for a fair presentation of our interim financial results. All such adjustments are of a normal and recurring nature. The results of operations for any interim period are not indicative of results for the full fiscal year.

The accompanying unaudited condensed consolidated interim financial statements include our accounts and those of our wholly-owned domestic and international subsidiaries. Intercompany accounts and transactions have been eliminated in consolidation.

Fair Value of Financial Instruments. The carrying values of cash and cash equivalents, accounts receivable, and accounts payable approximate the fair values of these financial instruments as of September 30, 2009 and December 31, 2008 due to their short maturities or variable rates.

Effective January 1, 2008, we adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* (SFAS 157), for financial assets and liabilities measured at fair value on a recurring basis. Effective January 1, 2009, we adopted the provisions of SFAS 157 for nonfinancial assets and liabilities measured at fair value on a recurring basis. SFAS 157 applies to all financial and nonfinancial assets and liabilities that are being measured and reported on a fair value basis, establishes a framework for measuring the fair value of assets and liabilities, and expands disclosures about fair value measurements. The adoption of SFAS 157 had no impact to our condensed consolidated interim financial statements. Effective July 1, 2009, this standard was incorporated into the Financial Accounting Standards Board Accounting Standard Codification (ASC) Section 820, *Fair Value Measurements and Disclosures (FASB ASC 820).* FASB ASC 820-10-50 requires fair value measurements be classified and disclosed in one of the following three categories:

- Level 1: Financial instruments with unadjusted, quoted prices listed on active market exchanges.
- Level 2: Financial instruments determined using prices for recently traded financial instruments with similar underlying terms as well as directly or indirectly observable inputs, such as interest rates and yield curves that are observable at commonly quoted intervals.
- Level 3: Financial instruments that are not actively traded on a market exchange. This category includes situations where there is little, if any, market activity for the financial instrument. The prices are determined using significant unobservable inputs or valuation techniques.

As of September 30, 2009 and December 31, 2008, we had available-for-sale marketable securities totaling $40.4 million and $57.6 million, respectively, consisting of investments in treasury bills, government and agency bonds, and certificates of deposits, all of which are valued at fair value using a market approach. A total of $38.7 million of our available-for-sale securities is valued based on quoted prices in active exchange markets (Level 1). The remaining $1.7 million is valued at fair value using other observable inputs (Level 2).

The fair value of our Convertible Senior Notes due 2014 was $170 million and $155 million as of September 30, 2009 and December 31, 2008, respectively, based on a quoted price in an active market (Level 1).

Subsequent Events. We adopted the provisions of SFAS No. 165, *Subsequent Events* (SFAS 165) during the three-month period ended June 30, 2009. Effective July 1, 2009, this standard was incorporated into the FASB ASC Section 855, Subsequent Events (FASB ASC 855). FASB ASC 855 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. The

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(UNAUDITED)

adoption of these standards did not impact our financial position or results of operations. We evaluated all events or transactions that occurred after September 30, 2009 through October 29, 2009, the date we issued these financial statements. See Note 11 to our condensed consolidated financial statements for further discussion of our subsequent event.

Prior Period Reclassification. Our condensed consolidated statement of cash flows for the nine-month period ended September 30, 2008 has been adjusted for an immaterial reclassification between operating activities and investing activities.

2. Inventories

Inventories consist of the following (in thousands):

	September 30, 2009	December 31, 2008
Raw materials	$ 8,939	$ 9,502
Work-in-process	26,490	34,811
Finished goods	130,910	131,746
	$ 166,339	$ 176,059

3. Property, Plant and Equipment, Net

Property, plant and equipment consist of the following (in thousands):

	September 30, 2009	December 31, 2008
Property, plant and equipment, at cost	$ 282,227	$ 254,543
Less: Accumulated depreciation	(144,562)	(120,892)
	$ 137,665	$ 133,651

4. Long-Term Debt and Capital Lease Obligations

Long-term debt and capital lease obligations consist of the following (in thousands):

	September 30, 2009	December 31, 2008
Capital lease obligations	$ 306	$ 261
Convertible senior notes	200,000	200,000
	200,306	200,261
Less: current portion	(162)	(125)
	$ 200,144	$ 200,136

In November 2007, we issued $200 million of Convertible Senior Notes due 2014. The notes will mature on December 1, 2014. The notes pay interest semiannually at an annual rate of 2.625% and are convertible into shares of our common stock at an initial conversion rate of 30.6279 shares per $1,000 principal amount of the notes, which represents a conversion price of $32.65 per share. The notes are unsecured obligations and are subordinated to all existing and future secured debt, our revolving credit facility, and all liabilities of our subsidiaries.

On September 30, 2009, our revolving credit facility had availability of $100 million, which can be increased by up to an additional $50 million at our request and subject to the agreement of the lenders. We currently have no borrowings outstanding under the credit facility. Borrowings under the credit facility will bear interest at the sum of a base annual rate plus an applicable annual rate that ranges from 0% to 1.75% depending on the type of loan and our consolidated leverage ratio, with a current annual base rate of 3.25%. The term of the credit facility extends through June 30, 2011.

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(UNAUDITED)

5. Goodwill and Intangible Assets

Changes in the carrying amount of goodwill occurring during the nine months ended September 30, 2009, are as follows (in thousands):

Goodwill at December 31, 2008	$ 49,682
Goodwill from contingent consideration associated with acquisitions	3,346
Foreign currency translation	397
Goodwill at September 30, 2009	$ 53,425

During the nine months ended September 30, 2009, we recognized contingent consideration of $2.1 million associated with our acquisition of Inbone Technologies, Inc., completed in 2008, $292,000 associated with the acquisition of the foot and ankle assets of A.M. Surgical, Inc., completed in 2008, $877,000 associated with the acquisition of certain assets of R&R Medical, Inc., completed in 2007, and $117,000 associated with the acquisition of the subtalar implant assets of Koby Ventures Ltd., d/b/a Metasurg, completed in 2007.

During the nine months ended September 30, 2009, we made payments for contingent consideration totaling $6.0 million, of which $2.6 million was accrued as of December 31, 2008.

The components of our identifiable intangible assets are as follows (in thousands):

	September 30, 2009		December 31, 2008	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Distribution channels	$ 22,669	$ 21,963	$ 21,625	$ 19,316
Completed technology	12,205	4,972	12,163	4,006
Licenses	6,828	3,774	6,301	3,504
Customer relationships	3,750	629	3,650	371
Trademarks	2,733	525	2,733	373
Other	3,208	1,458	3,360	1,172
	51,393	$ 33,321	49,832	$ 28,742
Less: Accumulated amortization	(33,321)		(28,742)	
Intangible assets, net	$ 18,072		$ 21,090	

Based on the intangible assets held at September 30, 2009, we expect to amortize approximately $5.2 million for the full year of 2009, $2.3 million in 2010, $2.3 million in 2011, $2.1 million in 2012, and $1.8 million in 2013.

6. Stock-Based Compensation

Amounts recognized within the condensed consolidated financial statements are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Total cost of share-based payment plans	$ 3,399	$ 3,240	$ 10,314	$ 10,209
Amounts capitalized as inventory and intangible assets	(402)	(318)	(1,052)	(1,067)
Amortization of capitalized amounts	335	431	938	1,346

Charged against income before income taxes	3,332	3,353	10,200	10,488
Amount of related income tax benefit	(968)	(1,118)	(3,005)	(3,098)
Impact to net income	2,364	2,235	7,195	7,390
Impact to basic earnings per share	$ 0.06	$ 0.06	$ 0.19	$ 0.20
Impact to diluted earnings per share	$ 0.06	$ 0.06	$ 0.19	$ 0.20

WRIGHT MEDICAL GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(UNAUDITED)

In the nine-month period ended September 30, 2009, we granted approximately 660,000 non-vested shares of common stock, 12,000 shares of stock-settled phantom stock units, and 71,000 restricted stock units at weighted-average fair values of $15.40, $14.79 and $15.47, respectively, which will be recognized on a straight line basis over the requisite service period that, for the substantial majority of these grants, is four years. As of September 30, 2009, we had approximately 4.2 million stock options outstanding (of which approximately 3.1 million were exercisable), 1.1 million non-vested shares of common stock outstanding, 39,000 stock-settled phantom stock units outstanding, and 68,000 restricted stock units outstanding.

As of September 30, 2009, we had $26.0 million of total unrecognized compensation cost related to unvested stock-based compensation arrangements granted to employees. That cost is expected to be recognized over a weighted-average period of 2.7 years.

7. Earnings Per Share

FASB ASC 260, *Earnings Per Share,* requires the presentation of basic and diluted earnings per share. Basic earnings per share is calculated based on the weighted-average number of shares of common stock outstanding during the period. Diluted earnings per share is calculated to include any dilutive effect of our common stock equivalents. Our common stock equivalents consist of stock options, non-vested shares of common stock, stock-settled phantom stock units, restricted stock units, and convertible debt. The dilutive effect of the stock options, non-vested shares of common stock, stock-settled phantom stock units, and restricted stock units is calculated using the treasury-stock method. The dilutive effect of convertible debt is calculated by applying the if-converted method. This assumes an add-back of interest, net of income taxes, to net income as if the securities were converted at the beginning of the period. During the three-month and six-month periods ending September 30, 2009 and 2008, the convertible debt had an anti-dilutive effect on earnings per share and we therefore excluded it from the dilutive shares calculation.

The weighted-average number of shares outstanding for basic and diluted earnings per share is as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	**2008**	**2009**	**2008**
Weighted-average number of shares outstanding, basic	37,431	37,095	37,331	36,845
Common stock equivalents	120	942	64	691
Weighted-average number of shares outstanding, diluted	37,551	38,037	37,395	37,536

The following potential common shares were excluded from common stock equivalents as their effect would have been anti-dilutive (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	**2008**	**2009**	**2008**
Stock options	4,120	920	4,118	