BOSTON SCIENTIFIC CORP
Form 10-Q
August 06, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended June 30, 2015

OR

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

Commission File No. 1-11083

BOSTON SCIENTIFIC CORPORATION
(Exact name of registrant as specified in its charter)

DELAWARE	04-2695240
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

300 BOSTON SCIENTIFIC WAY, MARLBOROUGH, MASSACHUSETTS 01752-1234
(Address of principal executive offices) (zip code)
(508) 683-4000
(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 þ No o

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).Yes þ No o

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.

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). Yes o No þ

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

Class	Shares outstanding as of July 31, 2015
Common Stock, $.01 par value	1,343,956,583

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PART I
FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

BOSTON SCIENTIFIC CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
in millions, except per share data	2015	2014	2015	2014
Net sales	$1,843	$1,873	$3,611	$3,647
Cost of products sold	540	563	1,060	1,100
Gross profit	1,303	1,310	2,551	2,547
Operating expenses:				
Selling, general and administrative expenses	700	743	1,367	1,409
Research and development expenses	220	206	412	397
Royalty expense	18	25	36	65
Amortization expense	116	109	229	218
Intangible asset impairment charges	9	110	9	165
Contingent consideration expense (benefit)	19	(96)	46	(118)
Restructuring charges	3	15	9	35
Litigation-related charges (credits)	(1)	267	192	260
Pension termination charges	—	—	8	—
Gain on divestiture	—	—	—	(12)
	1,084	1,379	2,308	2,419
Operating income (loss)	219	(69)	243	128
Other income (expense):				
Interest expense	(106)	(53)	(167)	(108)
Other, net	(8)	18	(22)	22
Income (loss) before income taxes	105	(104)	54	42
Income tax expense (benefit)	3	(108)	(47)	(95)
Net income (loss)	$102	$4	$101	$137
Net income (loss) per common share — basic	$0.08	$0.00	$0.08	$0.10
Net income (loss) per common share — assuming dilution	$0.08	$0.00	$0.07	$0.10
Weighted-average shares outstanding				
Basic	1,341.3	1,323.2	1,337.5	1,322.4
Assuming dilution	1,361.8	1,345.0	1,359.7	1,347.1

See notes to the unaudited condensed consolidated financial statements.

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BOSTON SCIENTIFIC CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
(in millions)	2015	2014	2015	2014
Net income (loss)	$102	$4	$101	$137
Other comprehensive income (loss):				
Foreign currency translation adjustment	5	(2)	(30)	(8)
Net change in unrealized gains and losses on derivative financial instruments, net of tax	(43)	(28)	(15)	(55)
Net change in certain retirement plans	—	—	5	(1)
Total other comprehensive income (loss)	(38)	(30)	(40)	(64)
Total comprehensive income (loss)	$64	$(26)	$61	$73

See notes to the unaudited condensed consolidated financial statements.

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BOSTON SCIENTIFIC CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

in millions, except share and per share data	As of June 30, 2015 (Unaudited)	December 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$903	$587
Trade accounts receivable, net	1,195	1,183
Inventories	968	946
Deferred and prepaid income taxes	316	447
Other current assets	391	443
Total current assets	3,773	3,606
Property, plant and equipment, net	1,451	1,507
Goodwill	5,930	5,898
Other intangible assets, net	5,442	5,606
Other long-term assets	527	425
TOTAL ASSETS	$17,123	$17,042
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current liabilities:		
Current debt obligations	$43	$403
Accounts payable	191	262
Accrued expenses	1,401	1,950
Other current liabilities	302	231
Total current liabilities	1,937	2,846
Long-term debt	5,069	3,859
Deferred income taxes	899	1,214
Other long-term liabilities	2,638	2,666
Commitments and contingencies		
Stockholders’ equity		
Preferred stock, $.01 par value - authorized 50,000,000 shares, none issued and outstanding		
Common stock, $.01 par value - authorized 2,000,000,000 shares and issued 1,589,722,340 shares as of June 30, 2015 and 1,575,018,236 shares as of December 31, 2014	16	16
Treasury stock, at cost - 247,566,270 shares as of June 30, 2015 and 247,566,270 shares as of December 31, 2014	(1,717)	(1,717)
Additional paid-in capital	16,764	16,703
Accumulated deficit	(8,587)	(8,689)
Accumulated other comprehensive income (loss), net of tax	104	144
Total stockholders’ equity	6,580	6,457
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$17,123	$17,042

See notes to the unaudited condensed consolidated financial statements.

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BOSTON SCIENTIFIC CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

in millions	Six Months Ended June 30, 2015	2014
Cash provided by (used for) operating activities	$(137)	$483
Investing activities:		
Purchases of property, plant and equipment	(92)	(124)
Purchases of privately held securities	(140)	(6)
Purchases of notes receivable	—	(10)
Proceeds from sales of publicly traded and privately held equity securities and collections of notes receivable	—	12
Payments for acquisitions of businesses, net of cash acquired	(63)	(72)
Payments for investments and acquisitions of certain technologies	(2)	(1)
Proceeds from business divestitures, net of costs	—	12
Cash provided by (used for) investing activities	(297)	(189)
Financing activities:		
Payments on long-term borrowings	(1,000)	—
Proceeds from long-term borrowings, net of debt issuance costs	1,831	—
Payment of contingent consideration	(87)	(15)
Proceeds from borrowings on credit facilities	395	650
Payments on borrowings from credit facilities	(395)	(650)
Payments for acquisitions of treasury stock	—	(125)
Cash used to net share settle employee equity awards	(62)	(47)
Proceeds from issuances of shares of common stock	70	33
Cash provided by (used for) financing activities	752	(154)
Effect of foreign exchange rates on cash	(2)	—
Net increase (decrease) in cash and cash equivalents	316	140
Cash and cash equivalents at beginning of period	587	217
Cash and cash equivalents at end of period	$903	$357
Supplemental Information		
Stock-based compensation expense	$53	$53
Fair value of contingent consideration recorded in purchase accounting	31	3

See notes to the unaudited condensed consolidated financial statements.

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NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE A – BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of Boston Scientific Corporation have been prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP) and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for fair presentation have been included. Operating results for the three and six month periods ended June 30, 2015 are not necessarily indicative of the results that may be expected for the year ending December 31, 2015. For further information, refer to the consolidated financial statements and footnotes thereto included in Item 8 of our 2014 Annual Report on Form 10-K.

Subsequent Events

We evaluate events occurring after the date of our most recent accompanying unaudited condensed consolidated balance sheets for potential recognition or disclosure in our financial statements. We did not identify any material subsequent events requiring adjustment to our accompanying unaudited condensed consolidated financial statements (recognized subsequent events) for the three and six month periods ended June 30, 2015. Those items requiring disclosure (unrecognized subsequent events) in the financial statements have been disclosed accordingly. Refer to Note B - Acquisitions and Strategic Investments, Note F - Borrowings and Credit Arrangements, as well as Note J - Commitments and Contingencies for more information.

NOTE B – ACQUISITIONS AND STRATEGIC INVESTMENTS

2015 Acquisitions

On August 3, 2015, we completed the acquisition of the American Medical Systems male urology portfolio (AMS Portfolio Acquisition), which includes the Men's Health and Prostate Health businesses, from Endo International plc. Total consideration was comprised of $1.600 billion in up-front cash plus related fees and expenses, and a potential additional $50 million payment in consideration based on 2016 sales.

On April 2, 2015, we acquired Xlumena, Inc. (Xlumena), a venture-backed medical device company that develops, manufactures and sells minimally invasive devices for Endoscopic Ultrasound (EUS) guided transluminal drainage of targeted areas within the gastrointestinal tract. The purchase agreement calls for an upfront payment of approximately $63 million, an additional payment of $13 million upon FDA clearance of the HOT AXIOS™ product, and further sales-based milestones based on sales achieved through 2018. We are in the process of integrating Xlumena into our Endoscopy business, and expect the integration to be substantially complete by the end of 2016.

Purchase Price Allocation

We accounted for the acquisition of Xlumena as a business combination and, in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification® (ASC) Topic 805, Business Combinations, we have recorded the assets acquired and liabilities assumed at their respective fair values as of the acquisition date. The components of the aggregate preliminary purchase price are as follows (in millions):

Cash, net of cash acquired	$ 63
Fair value of contingent consideration	31
	$ 94

The following summarizes the aggregate purchase price allocation for the 2015 acquisition as of June 30, 2015 (in millions):

Goodwill	$ 30
Amortizable intangible assets	68
Other net assets	3
Deferred income taxes	(7)
	$ 94

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We allocated a portion of the purchase price to specific intangible asset categories as follows:

	Amount Assigned (in millions)	Weighted Average Amortization Period (in years)	Range of Risk-Adjusted Discount Rates used in Purchase Price Allocation	
Amortizable intangible assets:				
Technology-related	$ 68	11	15	%
	$ 68			

2014 Acquisition

On May 7, 2014, we completed the acquisition of the remaining fully diluted equity of IoGyn, Inc. (IoGyn). Prior to the acquisition, we held approximately 28 percent minority interest in IoGyn in addition to notes receivable of approximately $8 million. Total consideration was comprised of a net cash payment of $65 million at closing to acquire the remaining 72 percent of IoGyn equity and repay outstanding debt. IoGyn developed the Symphion™ System, a next generation system for hysteroscopic intrauterine tissue removal including fibroids (myomas) and polyps. In March 2014, IoGyn received U.S. FDA approval for the system, and in the fourth quarter of 2014, we completed the first U.S. procedure. We are in the process of integrating the operations of the IoGyn business with our gynecological surgery business, which is part of our Urology and Women's Health business, and expect the integration to be substantially complete by the end of 2015.

Purchase Price Allocation
We accounted for the acquisition of IoGyn as a business combination and, in accordance with FASB ASC Topic 805, Business Combinations, we have recorded the assets acquired and liabilities assumed at their respective fair values as of the acquisition date. The components of the aggregate purchase price are as follows (in millions):

Cash, net of cash acquired	$ 65
Fair value of prior interests	31
	$ 96

We re-measured our previously held investments to their estimated acquisition-date fair value of $31 million and recorded a gain of $19 million in other, net, in the accompanying condensed consolidated statements of operations during the second quarter of 2014. We measured the fair values of the previously held investments based on the liquidation preferences and priority of the equity interests and debt, including accrued interest.

The following summarizes the aggregate purchase price allocation for the 2014 acquisition as of June 30, 2014 (in millions):

Goodwill	$ 39	
Amortizable intangible assets	72	
Other net assets	(1	)
Deferred income taxes	(14	)
	$ 96	

We allocated a portion of the purchase price to specific intangible asset categories as follows:

	Amount Assigned (in millions)	Weighted Average Amortization Period	Range of Risk-Adjusted Discount Rates used in

		(in years)	Purchase Price Allocation	
Amortizable intangible assets:				
Technology-related	$ 71	14	14	%
Other intangible assets	1	2	14	%
	$ 72			

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Our technology-related intangible assets consist of technical processes, intellectual property, and institutional understanding with respect to products and processes that we will leverage in future products or processes and will carry forward from one product generation to the next. We used the income approach to derive the fair value of the technology-related intangible assets, and are amortizing them on a straight-line basis over their assigned estimated useful lives.

We believe that the estimated intangible asset values represent the fair value at the date of acquisition and do not exceed the amount a third party would pay for the assets. These fair value measurements are based on significant unobservable inputs, including management estimates and assumptions and, accordingly, are classified as Level 3 within the fair value hierarchy prescribed by FASB ASC Topic 820, Fair Value Measurements and Disclosures.
We recorded the excess of the aggregate purchase price over the estimated fair values of the identifiable assets acquired as goodwill, which is not deductible for tax purposes. Goodwill was established due primarily to synergies expected to be gained from leveraging our existing operations as well as revenue and cash flow projections associated with future technologies, and has been allocated to our reportable segments based on the relative expected benefit. See Note D - Goodwill and Other Intangible Assets for more information related to goodwill allocated to our reportable segments.

Contingent Consideration

Certain of our acquisitions involve contingent consideration arrangements. Payment of additional consideration is generally contingent on the acquired company reaching certain performance milestones, including attaining specified revenue levels, achieving product development targets and/or obtaining regulatory approvals. In accordance with U.S. GAAP, we recognize a liability equal to the fair value of the contingent payments we expect to make as of the acquisition date. We re-measure this liability each reporting period and record changes in the fair value through a separate line item within our consolidated statements of operations.
We recorded a net expense related to the change in fair value of our contingent consideration liabilities of $19 million during the second quarter of 2015 and $46 million during the first half of 2015. We recorded net benefits of $96 million during the second quarter of 2014 and $118 million during the first half of 2014. We paid contingent consideration of $11 million during the second quarter of 2015, $110 million during the first half of 2015, $3 million during the second quarter of 2014 and $15 million during the first half of 2014.
Changes in the fair value of our contingent consideration liability were as follows (in millions):

Balance as of December 31, 2014	$274	
Amounts recorded related to new acquisitions	31	
Other amounts recorded related to prior acquisitions	—	
Net fair value adjustments	46	
Payments made	(110	)
Balance as of June 30, 2015	$241	

As of June 30, 2015, the maximum amount of future contingent consideration (undiscounted) that we could be required to pay was approximately $1.868 billion.

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Contingent consideration liabilities are re-measured to fair value each reporting period using projected revenues, discount rates, probabilities of payment and projected payment dates. The recurring Level 3 fair value measurements of our contingent consideration liability include the following significant unobservable inputs:

Contingent Consideration Liability	Fair Value as of June 30, 2015	Valuation Technique	Unobservable Input	Range
R&D, Regulatory and Commercialization-based Milestones	$14 million	Probability Weighted Discounted Cash Flow	Discount Rate	0.9% - 1.2%
			Probability of Payment	95% - 100%
			Projected Year of Payment	2015
Revenue-based Payments	$70 million	Probability Weighted Discounted Cash Flow	Discount Rate	11.5% - 15%
			Projected Year of Payment	2015 - 2018
	$157 million	Monte Carlo	Revenue Volatility	11% - 20%
			Risk Free Rate	LIBOR Term Structure
			Projected Year of Payment	2015-2018

Increases or decreases in the fair value of our contingent consideration liability can result from changes in discount periods and rates, as well as changes in the timing and amount of revenue estimates or in the timing or likelihood of achieving regulatory-, revenue- or commercialization-based milestones. Projected contingent payment amounts related to research and development, regulatory- and commercialization-based milestones and certain revenue-based milestones are discounted back to the current period using a discounted cash flow (DCF) model. Other revenue-based payments are valued using a Monte Carlo valuation model, which simulates future revenues during the earn-out period using management's best estimates. Projected revenues are based on our most recent internal operational budgets and long-range strategic plans. Increases in projected revenues and probabilities of payment may result in higher fair value measurements. Increases in discount rates and the time to payment may result in lower fair value measurements. Increases or decreases in any of those inputs together, or in isolation, may result in a significantly lower or higher fair value measurement.

2015 Strategic Investments

On April 30, 2015, we acquired a 27 percent ownership interest in Preventice, Inc. (Preventice), which includes 18.5 percent of Preventice's common stock. Preventice is a privately-held company headquartered in Minneapolis, MN, and a leading developer of mobile health solutions and services. Preventice offers a full portfolio of wearable cardiac monitors, including Holter monitors, cardiac event monitors and mobile cardiac telemetry. In addition to the equity agreement, we entered into a commercial agreement with Preventice, under which we will become Preventice’s exclusive, worldwide sales and marketing representative. We believe this partnership strengthens our portfolio of cardiac monitoring and broader disease management capabilities.

On April 13, 2015, we acquired 25 percent of the common stock of Frankenman Medical Equipment Company (Frankenman). Frankenman is a private company headquartered in Suzhou, China, and is a local market leader in surgical staplers. Additionally, we entered into co-promotional and co-selling agreements with Frankenman to jointly commercialize selected products in China. We believe this alliance will enable us to reach more clinicians and treat more patients in China by providing access to training on less invasive endoscopic technologies with clinical and economic benefits.

We are accounting for our investments in Preventice and Frankenman as equity method investments, in accordance with FASB ASC Topic 323, Investments - Equity Method and Joint Ventures. As of June 30, 2015, the book value of our equity method investments exceeded our share of the book value of the investees' underlying net assets by approximately $40 million, which represents amortizable intangible assets and corresponding deferred tax liabilities, and goodwill.

NOTE C – DIVESTITURES

In January 2011, we closed the sale of our Neurovascular business to Stryker Corporation for a purchase price of $1.500 billion in cash. We received $1.450 billion during 2011, an additional $10 million during 2012, $30 million during 2013 and the final amount due to us in 2014. At the time of divestiture, due to our continuing involvement in the operations of the Neurovascular business following the transaction, the divestiture did not meet the criteria for presentation as a discontinued operation. We recorded a gain of $12 million during the first half of 2014 associated with the Neurovascular divestiture.

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NOTE D – GOODWILL AND OTHER INTANGIBLE ASSETS

The gross carrying amount of goodwill and other intangible assets and the related accumulated amortization for intangible assets subject to amortization and accumulated write-offs of goodwill as of June 30, 2015 and December 31, 2014 are as follows:

	As of June 30, 2015		December 31, 2014	
(in millions)	Gross Carrying Amount	Accumulated Amortization/ Write-offs	Gross Carrying Amount	Accumulated Amortization/ Write-offs
Amortizable intangible assets				
Technology-related	$8,546	$(3,883)	$8,406	$(3,697)
Patents	521	(351)	519	(342)
Other intangible assets	878	(561)	875	(533)
	$9,945	$(4,795)	$9,800	$(4,572)
Unamortizable intangible assets				
Goodwill	$15,830	$(9,900)	$15,798	$(9,900)
Technology-related	197	—	197	—
	$16,027	$(9,900)	$15,995	$(9,900)

In addition, we had $95 million and $181 million of in-process research and development intangible assets as of June 30, 2015 and December 31, 2014, respectively. During the first half of 2015, we reclassified approximately $76 million of in-process research and development not previously subject to amortization to amortizable intangible assets due to the receipt of FDA approval of the WATCHMAN® device.

The following represents our goodwill balance by global reportable segment:

(in millions)	Cardiovascular	Rhythm Management	MedSurg	Total
Balance as of December 31, 2014	$3,426	$290	$2,182	$5,898
Purchase price adjustments	—	2	—	2
Goodwill acquired	—	—	30	30
Balance as of June 30, 2015	$3,426	$292	$2,212	$5,930