BOSTON SCIENTIFIC CORP
Form 10-Q
November 04, 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 September 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 October 30, 2015
Common Stock, $.01 par value	1,345,195,041

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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 September 30,		Nine Months Ended September 30,	
in millions, except per share data	2015	2014	2015	2014
Net sales	$1,888	$1,846	$5,499	$5,493
Cost of products sold	539	550	1,600	1,651
Gross profit	1,349	1,296	3,899	3,842
Operating expenses:				
Selling, general and administrative expenses	729	741	2,095	2,150
Research and development expenses	221	212	632	609
Royalty expense	17	21	53	86
Amortization expense	131	109	361	327
Intangible asset impairment charges	10	12	19	177
Contingent consideration expense (benefit)	40	(4)	86	(122)
Restructuring charges	7	2	16	37
Litigation-related charges (credits)	457	139	649	399
Pension termination charges	36	—	44	—
Gain on divestiture	—	—	—	(12)
	1,648	1,232	3,955	3,651
Operating income (loss)	(299)	64	(56)	191
Other income (expense):				
Interest expense	(58)	(54)	(225)	(161)
Other, net	(10)	(7)	(31)	15
Income (loss) before income taxes	(367)	3	(312)	45
Income tax expense (benefit)	(169)	(40)	(215)	(135)
Net income (loss)	$(198)	$43	$(97)	$180
Net income (loss) per common share — basic	$(0.15)	$0.03	$(0.07)	$0.14
Net income (loss) per common share — assuming dilution	$(0.15)	$0.03	$(0.07)	$0.13
Weighted-average shares outstanding				
Basic	1,344.0	1,325.5	1,339.7	1,323.5
Assuming dilution	1,344.0	1,347.6	1,339.7	1,347.3

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 September 30,		Nine Months Ended September 30,	
(in millions)	2015	2014	2015	2014
Net income (loss)	$(198)	$43	$(97)	$180
Other comprehensive income (loss):				
Foreign currency translation adjustment	(12)	(15)	(42)	(23)
Net change in unrealized gains and losses on derivative financial instruments, net of tax	(27)	83	(42)	28
Net change in certain retirement plans, net of tax	16	—	21	(1)
Total other comprehensive income (loss)	(23)	68	(63)	4
Total comprehensive income (loss)	$(221)	$111	$(160)	$184

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 September 30, 2015 (Unaudited)	December 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$350	$587
Trade accounts receivable, net	1,274	1,183
Inventories	1,086	946
Deferred and prepaid income taxes	367	447
Other current assets	385	443
Total current assets	3,462	3,606
Property, plant and equipment, net	1,479	1,507
Goodwill	6,468	5,898
Other intangible assets, net	6,228	5,606
Other long-term assets	578	425
TOTAL ASSETS	$18,215	$17,042
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current debt obligations	$63	$403
Accounts payable	210	262
Accrued expenses	1,605	1,950
Other current liabilities	360	231
Total current liabilities	2,238	2,846
Long-term debt	5,796	3,859
Deferred income taxes	770	1,214
Other long-term liabilities	3,001	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 - issued 1,592,429,606 shares as of September 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 September 30, 2015 and 247,566,270 shares as of December 31, 2014	(1,717)	(1,717)
Additional paid-in capital	16,815	16,703
Accumulated deficit	(8,785)	(8,689)
Accumulated other comprehensive income (loss), net of tax	81	144
Total stockholders' equity	6,410	6,457
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$18,215	$17,042

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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	Nine Months Ended September 30, 2015	2014
Cash provided by (used for) operating activities	$271	$829
Investing activities:		
Purchases of property, plant and equipment	(162)	(180)
Purchases of privately held securities	(209)	(6)
Purchases of notes receivable	(1)	(12)
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	(1,642)	(487)
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	(2,016)	(662)
Financing activities:		
Payments on long-term borrowings	(1,000)	—
Proceeds from long-term borrowings, net of debt issuance costs	2,580	—
Payment of contingent consideration	(102)	(15)
Proceeds from borrowings on credit facilities	565	810
Payments on borrowings from credit facilities	(565)	(810)
Payments for acquisitions of treasury stock	—	(125)
Cash used to net share settle employee equity awards	(62)	(48)
Proceeds from issuances of shares of common stock	97	52
Cash provided by (used for) financing activities	1,513	(136)
Effect of foreign exchange rates on cash	(5)	(2)
Net increase (decrease) in cash and cash equivalents	(237)	29
Cash and cash equivalents at beginning of period	587	217
Cash and cash equivalents at end of period	$350	$246
Supplemental Information		
Stock-based compensation expense	$79	$79
Fair value of contingent consideration recorded in purchase accounting	31	—

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 nine month periods ended September 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 nine month periods ended September 30, 2015. Those items requiring disclosure (unrecognized subsequent events) in the financial statements have been disclosed accordingly. Refer to Note J - Commitments and Contingencies for more information.

NOTE B – ACQUISITIONS AND STRATEGIC INVESTMENTS

2015 Acquisitions

AMS Portfolio Acquisition

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 $1.616 billion in up-front cash plus related fees and expenses, and a potential additional $50 million in consideration based on 2016 sales. The AMS male urology portfolio is being integrated with our formerly named Urology and Women's Health business, and the joint businesses have become Urology and Pelvic Health. In addition, as part of the acquisition agreement, we made a $60 million Series B non-voting preferred stock investment in the women's health business of Endo Health Solutions, a wholly owned subsidiary of Endo International, plc., representing the remaining Women's Health business of the American Medical Systems' Portfolio.

Xlumena, Inc.

On April 2, 2015, we acquired Xlumena, Inc. (Xlumena), a medical device company that developed minimally invasive devices for Endoscopic Ultrasound (EUS) guided transluminal drainage of targeted areas within the gastrointestinal tract. The purchase agreement called for an upfront payment of $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 these acquisitions as business combinations 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 dates. The components of the aggregate preliminary purchase prices are as follows (in millions):

Cash, net of cash acquired, including amounts payable as of September 30, 2015	$ 1,659
Fair value of contingent consideration	31
	$ 1,690

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The following summarizes the aggregate preliminary purchase price allocation for the 2015 acquisitions as of September 30, 2015 (in millions):

Goodwill	$ 568
Amortizable intangible assets	992
Inventory	102
Property, Plant and Equipment	42
Other net assets	39
Deferred income taxes	(53)
	$ 1,690

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	$ 358	11-12	13.5% - 15%
Customer relationships	616	12	13.5%
Other intangible assets	18	13	13.5%
	$ 992		

2014 Acquisitions

Interventional Business of Bayer AG

On August 29, 2014, we completed the acquisition of the Interventional Division of Bayer AG (Bayer), for total cash consideration of $414 million. We believe that this acquisition enhances our ability to offer physicians and healthcare systems a more complete portfolio of solutions to treat challenging vascular conditions. The transaction includes the AngioJet® Thrombectomy System and the Fetch® 2 Aspiration Catheter, which are used in endovascular procedures to remove blood clots from blocked arteries and veins, and the JetStream® Atherectomy System, used to remove plaque and thrombi from diseased arteries. We are in the process of integrating Bayer into our Peripheral Intervention and Interventional Cardiology businesses, and expect the integration to be substantially complete by the middle of 2016.

IoGyn, Inc.

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 $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. We have substantially completed the process of integrating the operations of the IoGyn business with our gynecological surgery business, which is part of our Urology and Pelvic Health business.

Purchase Price Allocation

We accounted for these acquisitions as business combinations 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 dates. The components of the aggregate purchase prices are as follows (in millions):

Cash, net of cash acquired	$479
Fair value of prior interests	31
	$510

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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 acquisitions as of September 30, 2014 (in millions):

Goodwill	$210
Amortizable intangible assets	263
Inventory	23
Property, Plant and Equipment	17
Prepaid Transaction Service Agreements	5
Other net assets	(1)
Deferred income taxes	(7)
	$510

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	$233	10 - 14	14 - 18 %
Customer relationships	29	10	18%
Other intangible assets	1	2	14%
	$263		

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.

Customer relationships represent the estimated fair value of non-contractual customer and distributor relationships. Customer relationships are direct relationships with physicians and hospitals performing procedures with the acquired products, and distributor relationships are relationships with third parties used to sell products, both as of the acquisition date. These relationships were valued separately from goodwill because there is a history and pattern of conducting business with customers and distributors. We used the income approach or the replacement cost and lost profits methodology to derive the fair value of the customer relationships. The customer relationships intangible assets are amortized on a straight-line basis over their assigned estimated useful lives.

Other intangible assets primarily include acquired tradenames. These tradenames include brand names that we expect to continue using in our product portfolio and related marketing materials. The tradenames are valued using a relief from royalty methodology and are amortized 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.

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We recorded the excess of the aggregate purchase price over the estimated fair values of the identifiable assets acquired as goodwill. 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. Of the goodwill recorded, approximately $500 million, based on preliminary estimates, related to our 2015 acquisitions and approximately $150 million related to our 2014 acquisitions is deductible for tax purposes. 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 $40 million during the third quarter of 2015 and $86 million during the first nine months of 2015. We recorded net benefits of $4 million during the third quarter of 2014 and $122 million during the first nine months of 2014. We paid contingent consideration of $15 million during the third quarter of 2015 and $125 million during the first nine months of 2015. We made no payments of contingent consideration during the third quarter of 2014 and we made payments of $15 million during the first nine months 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	86
Payments made	(125)
Balance as of September 30, 2015	$266

As of September 30, 2015, the maximum amount of future contingent consideration (undiscounted) that we could be required to pay was approximately $1.893 billion.

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 September 30, 2015	Valuation Technique	Unobservable Input	Range
Revenue-based Payments	$84 million	Probability Weighted Discounted Cash Flow	Discount Rate	11.5% - 15%
			Projected Year of Payment	2015 - 2019
	$182 million	Monte Carlo	Revenue Volatility	11% - 20%
			Risk Free Rate	LIBOR Term Structure
			Projected Year of Payment	2015 - 2018

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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 milestones. Projected contingent payment amounts related to 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.

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 September 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. During the three and nine months ended September 30, 2015, the net losses from our equity method adjustments, presented within the Other, net caption of our condensed consolidated statement of operations were de minimis.

We did not close any material strategic investments in the third quarter or first nine months of 2014.

NOTE C – DIVESTITURES AND PENSION TERMINATION

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 nine months of 2014 associated with the Neurovascular divestiture.

Following our 2006 acquisition of Guidant Corporation, we sponsored the Guidant Retirement Plan, a frozen noncontributory defined benefit plan covering a select group of current and former employees. The plan was partially frozen as of September 25, 1995 and completely frozen as of May 31, 2007, and was terminated effective December 1, 2014. During 2015, we finalized the termination process and settled the plan's obligations, and as a result, we have recorded pension termination charges of $36 million and $44 million during the third quarter and first nine months of 2015.

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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 September 30, 2015 and December 31, 2014 are as follows:

	As of September 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	$8,874	$(3,952)	$8,406	$(3,697)
Patents	519	(354)	519	(342)
Other intangible assets	1,512	(584)	875	(533)
	$10,905	$(4,890)	$9,800	$(4,572)
Unamortizable intangible assets				
Goodwill	$16,368	$(9,900)	$15,798	$(9,900)
In-process research and development (IPR&D)	93	—	181	—
Technology-related	120	—	197	—
	$16,581	$(9,900)	$16,176	$(9,900)

During the third quarter of 2015, we reclassified approximately $77 million of core technology not previously subject to amortization to amortizable intangible assets due to projected changes in the market for this technology. We tested the intangible asset for impairment prior to this reclassification and determined that the asset was not impaired.

In addition, during the third quarter of 2015, we reclassified $1 million of IPR&D not previously subject to amortization to amortizable intangible assets, as a result of regulatory approvals, for a total of $77 million of IPR&D assets not previously subject to amortization reclassified as amortizable intangible assets during the first nine months of 2015. The IPR&D reclassified to amortizable intangible assets during the first nine months of 2015 primarily related 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	—	—	568	568
Balance as of September 30, 2015	$3,426	$292	$2,750	$6,468

Goodwill Impairment Testing

We test our goodwill balances during the second quarter of each year for impairment, or more frequently if indicators are present or changes in circumstances suggest that an impairment may exist.

In the second quarter of 2015, we performed our annual goodwill impairment test for all of our reporting units and concluded the fair value of each reporting unit exceeded its carrying value. As a result of the 2015 annual goodwill impairment test, we identified our global Electrophysiology reporting unit as being at higher risk of potential failure of the first step of the goodwill impairment test in future reporting periods. As of the date of our annual goodwill impairment test, our global Electrophysiology reporting unit had excess fair value over carrying value of approximately 28 percent and held $292 million of allocated goodwill. Also, as of the date of our annual goodwill impairment test, our global Cardiac Rhythm Management (CRM) reporting unit had excess fair value over carrying value of approximately 26 percent; however, due to goodwill impairment charges in prior years, no goodwill remains within our CRM reporting unit. Changes in our reporting units or in the structure of our business as a result of future reorganizations, acquisitions or divestitures of assets or businesses could result in future impairments of goodwill within our reporting units. Refer to Critical Accounting Policies and Estimates within our Management's Discussion and Analysis of Financial Condition and Results of Operations contained in Item 2 of this Quarterly Report on Form 10-Q for a discussion of key assumptions used in our testing.

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On a quarterly basis, we monitor the key drivers of fair value to detect events or other changes that would warrant an interim impairment test of our goodwill. The key variables that drive the cash flows of our reporting units and amortizable intangibles are estimated revenue growth rates and levels of profitability. Terminal value growth rate assumptions, as well as the Weighted Average Cost of Capital (WACC) rate applied are additional key variables for reporting unit cash flows. These assumptions are subject to uncertainty, including our ability to grow revenue and improve profitability levels. Relatively small declines in the future performance and cash flows of a reporting unit or asset group or small changes in other key assumptions may result in the recognition of significant goodwill impairment charges. For example, as of the date of our annual goodwill impairment test, keeping all other variables constant, a combined increase of 50 basis points in the WACC along with a simultaneous decrease of 150 basis points in the long term growth rate applied would require that we perform the second step of the goodwill impairment test for our global Electrophysiology reporting unit. The estimates used for our future cash flows and discount rates represent management's best estimates, which we believe to be reasonable, but future declines in business performance may impair the recoverability of our goodwill.

Future events that could have a negative impact on the levels of excess fair value over carrying value of our reporting units include, but are not limited to:

- decreases in estimated market sizes or market growth rates due to greater-than-expected declines in procedural volumes, pricing pressures, reductions in reimbursement levels, product actions, and/or competitive technology developments;
- declines in our market share and penetration assumptions due to increased competition, an inability to develop or launch new and next-generation products and technology features in line with our commercialization strategies, and market and/or regulatory conditions that may cause significant launch delays or product recalls;
- decreases in our forecasted profitability due to an inability to successfully implement and achieve timely and sustainable cost improvement measures consistent with our expectations;
- negative developments in intellectual property litigation that may impact our ability to market certain products or increase our costs to sell certain products;
- the level of success of ongoing and future research and development efforts, including those related to recent acquisitions, and increases in the research and development costs necessary to obtain regulatory approvals and launch new products;
- the level of success in managing the growth of acquired companies, achieving sustained profitability consistent with our expectations, establishing government and third-party payer reimbursement, supplying the market, and increases in the costs and time necessary to integrate acquired businesses into our operations successfully;
- changes in our reporting units or in the structure of our business as a result of future reorganizations, acquisitions or divestitures of assets or businesses; and
- increases in our market-participant risk-adjusted WACC, and increases in our market-participant tax rate, and/or changes in tax laws or macroeconomic conditions.

Negative changes in one or more of these factors, among others, could result in impairment charges.

The following is a rollforward of accumulated goodwill write-offs by global reportable segment:

(in millions)	Cardiovascular	MedSurg	Total

		Rhythm Management		
Accumulated write-offs as of December 31, 2014	$(1,479)	$(6,960)	$(1,461)	$(9,900)
Goodwill written off	—	—	—	—
Accumulated write-offs as of September 30, 2015	$(1,479)	$(6,960)	$(1,461)	$(9,900)

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Intangible Asset Impairment Testing

2015 Charges

During the third quarter of 2015, we performed our annual impairment test of all IPR&D projects and our indefinite-lived core technology assets. Indefinite-lived intangible assets are tested for impairment on an annual basis during the third quarter of each year, or more frequently if impairment indicators are present, in accordance with U.S. GAAP and our accounting policies described in our 2014 Annual Report on Form 10-K. In addition, as a result of revised estimates in conjunction with our annual operating plan, we performed an interim impairment test of certain definite-lived core technology associated with certain of our acquisitions. Based on the results of our testing, we recorded impairment charges of $10 million in the third quarter of 2015.

During the second quarter of 2015, in conjunction with our annual strategic planning process and annual goodwill impairment test, we performed an interim impairment test on certain of our IPR&D projects and core technology assets. Based on our impairment assessment, we recorded an impairment charge of $9 million in the second quarter of 2015.

2014 Charges

During the third quarter of 2014, we performed our annual impairment test of all IPR&D projects, and our indefinite-lived core technology assets. Based on the results of our annual test, we recorded total impairment charges of $4 million to write-down the balances of certain in-process projects to their fair value. In addition, as a result of revised estimates in conjunction with our annual operating plan, we performed an interim impairment test of core technology associated with certain of our acquisitions, and we recorded an impairment charge of $8 million, for a total of $12 million of impairment charges in the third quarter of 2014.

During the second quarter of 2014, as a result of revised estimates developed in conjunction with our annual strategic planning process and annual goodwill impairment test, we performed an interim impairment test of our IPR&D projects and core technology associated with certain of our acquisitions. Based on our impairment assessment, and lower expected future cash flows associated with our intangible assets, we recorded pre-tax impairment charges of $110 million in the second quarter of 2014. As a result of changes in our clinical strategy and lower estimates of the European and global hypertension markets, and the resulting amount of future revenue and cash flows associated with the technology acquired from Vessix Vascular Inc. (Vessix), we recorded impairment charges of $67 million related to technology intangible assets during the second quarter of 2014. In addition, in the second quarter of 2014, due to revised expectations and timing as a result of the announcement of a third FDA Circulatory System Devices Panel, we recorded impairment charges of $35 million related to the IPR&D intangible assets acquired from Atritech, Inc. (Atritech). We also recorded an additional $8 million intangible asset impairment charge associated with changes in the amount of the expected cash flows related to certain other acquired IPR&D projects.

During the first quarter of 2014, as a result of lower estimates of the resistant hypertension market following the announcement of data from a competitor's clinical trial, we performed an interim impairment test of our IPR&D projects and core technology associated with our acquisition of Vessix. The impairment assessments were based upon probability-weighted cash flows of potential future scenarios. Based on our impairment assessment, and lower expected future cash flows associated with our Vessix-related intangible assets, we recorded pre-tax impairment charges of $55 million in the first quarter of 2014 to write-down the balance of these intangible assets to their calculated fair value.

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The nonrecurring Level 3 fair value measurements of our intangible asset impairment analysis included the following significant unobservable inputs:

Intangible Asset	Valuation Date	Fair Value	Valuation Technique	Unobservable Input	Rate
Core Technology	September 30, 2015	$8 million	Income Approach -Excess Earnings Method	Discount Rate	10%
In-Process R&D	June 30, 2015	$6 million	Income Approach - Excess Earnings Method	Discount Rate	16.5 - 20%
In-Process R&D	September 30, 2014	$16 million	Income Approach - Excess Earnings Method	Discount Rate	16.5 - 20%
In-Process R&D	June 30, 2014	$83 million	Income Approach - Excess Earnings Method	Discount Rate	16.5 - 20%
Core Technology	June 30, 2014	$8 million	Income Approach - Excess Earnings Method	Discount Rate	15%
In-Process R&D	March 31, 2014	$6 million	Income Approach - Excess Earnings Method	Discount Rate	20%
Core Technology	March 31, 2014	$64 million	Income Approach - Excess Earnings Method	Discount Rate	15%

NOTE E – FAIR VALUE MEASUREMENTS

Derivative Instruments and Hedging Activities

We address market risk from changes in foreign currency exchange rates and interest rates through a risk management program that includes the use of derivative financial instruments, and we operate the program pursuant to documented corporate risk management policies. Our derivative instruments do not subject our earnings or cash flows to material risk, as gains and losses on these derivatives generally offset losses and gains on the item being hedged. We do not enter into derivative transactions for speculative purposes, and we do not have any non-derivative instruments that are designated as hedging instruments pursuant to FASB ASC Topic 815, Derivatives and Hedging (Topic 815).

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Currency Hedging

We are exposed to currency risk consisting primarily of foreign currency denominated monetary assets and liabilities, forecasted foreign currency denominated intercompany and third-party transactions and net investments in certain subsidiaries. We manage our exposure to changes in foreign currency exchange rates on a consolidated basis to take advantage of offsetting transactions. We use derivative instruments, and non-derivative transactions to reduce the risk that our earnings and cash flows associated with these foreign currency denominated balances and transactions will be adversely affected by foreign currency exchange rate changes.

Currently or Previously Designated Foreign Currency Hedges

All of our designated currency hedge contracts outstanding as of September 30, 2015 and December 31, 2014 were cash flow hedges under Topic 815 intended to protect the U.S. dollar value of our forecasted foreign currency denominated transactions. We record the effective portion of any change in the fair value of foreign currency cash flow hedges in other comprehensive income (OCI) until the related third-party transaction occurs. Once the related third-party transaction occurs, we reclassify the effective portion of any related gain or loss on the foreign currency cash flow hedge to earnings. In the event the hedged forecasted transaction does not occur, or it becomes no longer probable that it will occur, we reclassify the amount of any gain or loss on the related cash flow hedge to earnings at that time. We had currency derivative instruments currently or previously designated as cash flow hedges outstanding in the contract amount of $1.517 billion as of September 30, 2015 and $2.178 billion as of December 31, 2014.

We recognized net gains of $54 million in earnings on our cash flow hedges during the third quarter of 2015 and $156 million for the first nine months of 2015, as compared to net gains of $25 million during the third quarter of 2014 and $68 million for the first nine months of 2014. All currency cash flow hedges outstanding as of September 30, 2015 mature within 36 months. As of September 30, 2015, $171 million of net gains, net of tax, were recorded in accumulated other comprehensive income (AOCI) to recognize the effective portion of the fair value of any currency derivative instruments that are, or previously were, designated as foreign currency cash flow hedges, as compared to net gains of $217 million as of December 31, 2014. As of September 30, 2015, $114 million of net gains, net of tax, may be reclassified to earnings within the next twelve months.

The success of our hedging program depends, in part, on forecasts of transaction activity in various currencies (primarily Japanese yen, Euro, British pound sterling, Australian dollar and Canadian dollar). We may experience unanticipated currency exchange gains or losses to the extent that there are differences between forecasted and actual activity during periods of currency volatility. In addition, changes in foreign currency exchange rates related to any unhedged transactions may impact our earnings and cash flows.

Non-designated Foreign Currency Contracts

We use currency forward contracts as a part of our strategy to manage exposure related to foreign currency denominated monetary assets and liabilities. These currency forward contracts are not designated as cash flow, fair value or net investment hedges under Topic 815; are marked-to-market with changes in fair value recorded to earnings; and are entered into for periods consistent with currency transaction exposures, generally less than one year. We had currency derivative instruments not designated as hedges under Topic 815 outstanding in the contract amount of $1.947 billion as of September 30, 2015 and $2.470 billion as of December 31, 2014.

Interest Rate Hedging

Our interest rate risk relates primarily to U.S. dollar borrowings, partially offset by U.S. dollar cash investments. We have historically used interest rate derivative instruments to manage our earnings and cash flow exposure to changes in interest rates by converting floating-rate debt into fixed-rate debt or fixed-rate debt into floating-rate debt.

We designate these derivative instruments either as fair value or cash flow hedges under Topic 815. We record changes in the value of fair value hedges in interest expense, which is generally offset by changes in the fair value of the hedged debt obligation. Interest payments made or received related to our interest rate derivative instruments are included in interest expense. We record the effective portion of any change in the fair value of derivative instruments designated as cash flow hedges as unrealized gains or losses in OCI, net of tax, until the hedged cash flow occurs, at which point the effective portion of any gain or loss is reclassified to earnings. We record the ineffective portion of our cash flow hedges in interest expense. In the event the hedged cash flow does not occur, or it becomes no longer probable that it will occur, we reclassify the amount of any gain or loss on the related cash flow hedge to interest expense at that time.

In the fourth quarter of 2013, we entered into interest rate derivative contracts having a notional amount of $450 million to convert fixed-rate debt into floating-rate debt, which we designated as fair value hedges. During the first quarter of 2015, we terminated these hedges and we received total proceeds of approximately $35 million, which included approximately $7 million of net accrued interest receivable. We assessed at inception, and re-assessed on an ongoing basis, whether the interest rate derivative contracts were highly effective in offsetting changes in the fair value of the hedged fixed-rate debt. We recognized no gains or losses in interest expense, related to fair value hedges, during the third quarter of 2015. During the first nine months of 2015, we recognized, in interest expense, an $8 million loss on our hedged debt and an $8 million gain on the related interest rate derivative contract. During the third quarter of 2014, we recognized, in interest expense, a $1 million gain on our hedged debt and a $1 million loss on the related interest rate derivative contract. During the first nine months of 2014, we recognized, in interest expense, a $17 million loss on our hedged debt and a $17 million gain on the related interest rate derivative contract.

During the second quarter of 2015, we entered into forward starting interest rate derivative contracts having a notional amount of $450 million to hedge interest rate risk associated with a planned issuance of fixed-rate senior notes, which we designated as cash flow hedges. These hedges were terminated during the second quarter at the time we issued the fixed-rate senior notes and we received total proceeds of approximately $11 million. We had no amounts outstanding under these hedges as of September 30, 2015. We assessed, at inception, and re-assessed, on an ongoing basis, whether the cash flow derivative contracts were highly effective in offsetting changes in interest rates. The gain on this derivative contract was recorded within accumulated other comprehensive income, and is being amortized into earnings as a credit to interest expense over the life of the related senior notes.

We are amortizing the gains and losses on previously terminated interest rate derivative instruments, including fixed-to-floating interest rate contracts designated as fair value hedges and forward starting interest rate derivative contracts and treasury locks designated as cash flow hedges upon termination into earnings as a component of interest expense over the remaining term of the hedged debt, in accordance with Topic 815. The carrying amount of certain of our senior notes included unamortized gains of $66 million as of September 30, 2015 and $45 million as of December 31, 2014, and unamortized losses of $1 million as of September 30, 2015 and $2 million as of December 31, 2014 related to the fixed-to-floating interest rate contracts that we terminated in prior periods. In addition, we had pre-tax net gains within AOCI related to terminated forward starting interest rate derivative contracts and treasury locks of $10 million as of September 30, 2015 and $2 million as of December 31, 2014. We recorded approximately $3 million during the third quarter of 2015 and $10 million during the first nine months of 2015 as a reduction to interest expense, resulting from the amortization of terminated interest rate derivative contracts. As of September 30, 2015, $13 million of pre-tax net gains may be reclassified to earnings within the next twelve months as a reduction to interest expense from amortization of our terminated interest rate derivative contracts.

Counterparty Credit Risk

We do not have significant concentrations of credit risk arising from our derivative financial instruments, whether from an individual counterparty or a related group of counterparties. We manage the concentration of counterparty credit risk on our derivative instruments by limiting acceptable counterparties to a diversified group of major financial institutions with investment grade credit ratings, limiting the amount of credit exposure to each counterparty, and actively monitoring their credit ratings and outstanding fair values on an ongoing basis. Furthermore, none of our derivative transactions are subject to collateral or other security arrangements and none contain provisions that are dependent on our credit ratings from any credit rating agency.

We also employ master netting arrangements that reduce our counterparty payment settlement risk on any given maturity date to the net amount of any receipts or payments due between us and the counterparty financial institution. Thus, the maximum loss due to counterparty credit risk is limited to the unrealized gains in such contracts net of any unrealized losses should any of these counterparties fail to perform as contracted. Although these protections do not eliminate concentrations of credit risk, as a result of the above considerations, we do not consider the risk of counterparty default to be significant.

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Fair Value of Derivative Instruments

The following presents the effect of our derivative instruments designated as cash flow hedges under Topic 815 on our accompanying unaudited condensed consolidated statements of operations during the third quarter and first nine months of 2015 and 2014 (in millions):

	Amount of Pre-tax Gain (Loss) Recognized in OCI (Effective Portion)	Amount of Pre-tax Gain (Loss) Reclassified from AOCI into Earnings (Effective Portion)	Location in Statement of Operations
Three Months Ended September 30, 2015			
Currency hedge contracts	$13	$54	Cost of products sold
	$13	$54	
Three Months Ended September 30, 2014			
Currency hedge contracts	$156	$25	Cost of products sold
	$156	$25	
Nine Months Ended September 30, 2015			
Currency hedge contracts	$81	$156	Cost of products sold
Interest rate derivative contracts	11	2	Interest Expense
	$92	$158	
Nine Months Ended September 30, 2014			
Currency hedge contracts	$115	$68	Cost of products sold
	$115	$68	

The amount of gain (loss) recognized in earnings related to the ineffective portion of hedging relationships was de minimis for all periods presented.

Net gains and losses on currency hedge contracts not designated as hedging instruments were offset by net losses and gains from foreign currency transaction exposures, as shown in the following table:

in millions	Location in Statement of Operations	Three Months Ended September 30, 2015	2014	Nine Months Ended September 30, 2015	2014
Gain (loss) on currency hedge contracts	Other, net	$32	$40	$46	$20
Gain (loss) on foreign currency transaction exposures	Other, net	(36)	(45)	(64)	(31)
Net foreign currency gain (loss)	Other, net	$(4)	$(5)	$(18	